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Washington, D.C. 20402

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

These principles of tax administration were previously published in the Internal Revenue Bulletin as Revenue Procedure 64-22, 1964-1 (Part I) C.B. 689. They are restated here to emphasize their importance to all employees of the Internal Revenue Service.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the entire state of facts involved. In those that are based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and confidential information are deleted to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

Cumulative Bulletin 1985-2 is a consolidation of all items of permanent nature published in the weekly Bulletins 1985-26 through 1985-52 for the period of July 1 through December 31, 1985.

The Internal Revenue Cumulative Bulletin is prepared in three parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954. Arrangement is sequential according to Code and regulations sections. The code section is shown at the top of each page.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Included in this Part is a list of persons disbarred or suspended from practice before the Internal Revenue Service.

Notice of Proposed Rulemaking

The preambles and text of proposed regulations that were published in the **Federal Register** during this six-month period are printed in this section.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Services No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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Cumulative List of Announcements Relating to Decisions of the Tax Court Published in the Internal Revenue Bulletin from January 1, 1985 thru December 31, 1985

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by Revenue officers and others concerned as conclusions of the service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance approval of any or all of the reasons assigned by the court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the tax court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report Volume	Page
Cologne Life Reinsurance Co.[1]	10337-81	80	859
Cooper, Robert E.[2]	3164–75 6401-75	67	870
Gershman Family Foundation, Harold & Julia[3]	16385-84	83	217
Sibla, Richard R.[4]	2864-76	68	422

[1]Acquiescence relating to whether the taxpayer is entitled to take into account the reserves held and the premiums received under its risk premium reinsurance contracts in computing the deduction under section 809(d)(5) of the Code.

[2]Nonacquiescence published in 1978-1 C.B. 2, relating to whether payments made by petitioner for meal expenses in connection with his employment as a fireman are deductible under section 162(a) of the Code or excludable under section 119(b)(3), is withdrawn and acquiescence is substituted therefore.

[3]Acquiescence relating to whether the petitioner, a disqualified person with respect to the private foundation, committed an act of self-dealing proscribed by section 4941(d)(1)(A) of the Code when he transferred to the foundation a promissory note subject to two senior notes secured by an all-inclusive deed of trust.

[4]Nonacquiescence published in 1978-1 C.B. 3, relating to whether payments made by petitioner for meal expenses in connection with his employment as a fireman are deductible under section 162(a) of the Code or excludable under section 119(b)(3), is withdrawn and acquiescence is substituted therefore.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Subpart A.—Income Taxes
Chapter 1.—Normal Taxes and Surtaxes
Subchapter A.—Determination of Tax Liability
Part I.—Tax on Individuals

Section 1.—Tax Imposed

26 CFR 1.1-1: Income tax on individuals.

Adjusted tax tables set forth for taxable years beginning in 1986. See Rev. Proc. 85-55, page 737.

Part IV.—Credits Against Tax
Subpart A.—Nonrefundable Personal Credits

Section 25.—Interest on Certain Home Mortgages

26 CFR 1.25-4T: Qualified mortgage credit certificate program.

T.D. 8048

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, SUBCHAPTER H, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Information Reporting for Mortgage Credit Certificates

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations that relate to mortgage credit certificates. Changes to the applicable tax law were made by the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. These regulations affect all holders and issuers of mortgage credit certificates. In addition, the text contained in the temporary regulations set forth in this document serves as the text of the proposed regulations cross-referenced * * * [on page 842, this Bulletin].

DATES: These regulations are effective with respect to mortgage credit certificates issued after September 30, 1985.

FOR FURTHER INFORMATION CONTACT: Mitchell H. Rapaport of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3740).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains amendments to the temporary regulations relating to mortgage credit certificates under section 25 of the Internal Revenue Code of 1954 as amended by section 612 of the Tax Reform Act of 1984 (Pub. L. 98-369; 98 Stat. 905) [1984-3 C.B. (Vol. 1) 1, 413]. The temporary regulations provided by this document will remain in effect until superseded by final regulations on this subject.

EXPLANATION OF PROVISIONS

Section 25 authorizes States and political subdivisions ("issuers") to issue mortgage credit certificates ("MCCs") in lieu of qualified mortgage bonds. MCCs entitle qualifying individuals to a credit against the individuals' Federal income tax. The amount of the credit is determined by multiplying the certificate credit rate by the amount of interest paid or accrued by the taxpayer during the taxpayer's taxable year on the certified indebtedness amount. In order for an individual to claim the credit provided by section 25, the MCC must be a "qualified mortgage credit certificate" issued pursuant to a "qualified mortgage credit certificate program". The requirements of section 103A(j), including the State certification requirement, the policy statement requirement, and the information reporting requirement, must be met in order for a program to be a qualified mortgage credit certificate program.

On May 8, 1985, temporary and proposed regulations with respect to MCCs were published in the FEDERAL REGISTER (50 FR 19344; 50 FR 19383) [T.D. 8023, 1985-1 C.B. 1; LR-245-84, 1985-1 C.B. 659]. Those regulations reserved §1.25-4T(e), relating to the information reporting requirement, and §1.25-4T(f), relating to the policy statement requirement. The Service received numerous written comments responding to a notice of proposed rulemaking published in the FEDERAL REGISTER on December 12, 1984 (49 FR 48323) [LR-240-84, 1985-1 C.B. 658], with respect to the reporting and policy statement requirements as they apply to qualified mortgage bonds and qualified veterans' mortgage bonds, and a public hearing was held on April 30, 1985. After consideration of all comments regarding those proposed regulations, temporary and proposed regulations relating to the information reporting and policy statement requirements applicable to mortgage credit certificates are being provided.

Section 1.25-4T(e) contains the information reporting requirements applicable to issuers of mortgage credit certificates. This requirement must be satisfied for a program to be a qualified mortgage credit certificate program. In order to satisfy the information reporting requirement, an issuer must submit a report concerning the holders of certificates issued during the relevant reporting period. The information required to be submitted is to be presented in tabular form. Section 1.25-4T(e)(1)(i) requires the submission of information concerning the number of mortgage credit certificates categorized according to the income of the holders and the acquisition cost of the residences; this information is to be further categorized according to whether the holders had no present ownership interest in their principal residences at any time during the 3-year period ending on the date the MCC is executed (*i.e.*, satisfy the 3-year requirement) and whether the residences are located in targeted areas. In addition, information concerning the fees charged to the holders must be submitted. Section 1.25-4T(e)(1)(ii) requires the submission of information concerning the volume of MCCs (*i.e.*, the total of the certified indebtedness amount of the certificates issued and the sum of the products of the certified indebtedness amount and the certificate credit rate for each certificate) according to the income of the holders and the acquisition cost of the residences; this information is also to be categorized according to whether the holders satisfy the 3-year requirement and whether the residences are located in targeted areas. With respect to home improvement and rehabilitation loans, §1.25-4T(e)(1)(iii) requires the submission of information

concerning the number and volume of such loans categorized according to whether the residences are located in targeted areas.

Section 1.25-4T(f) contains the policy statement requirement. In order for a program to be a qualified mortgage credit certificate program, the applicable elected representative of the governmental unit which is the issuer (or on whose behalf the certificates were issued) must have published (after a public hearing following reasonable public notice) a policy statement by the last day of the year preceding the year in which the election not to issue qualified mortgage bonds was made, and the respresentative must have submitted a copy of the policy statement to the Commissioner. The provisions concerning the policy statement that must be submitted by issuers of MCCs are identical to those applicable to issuers of qualified mortgage bonds. See §1.103A-2(1).

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis therefore is not required.

REGULATORY FLEXIBILITY ANALYSIS

A general notice of proposed rulemaking is not required by 5 U.S.C. 553 for temporary regulations. Accordingly, the temporary regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

PAPERWORK REDUCTION ACT

The collection of information requirements contained in these regulations have been submitted to the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by the OMB under control number 1545-0922.

DRAFTING INFORMATION

The principal author of these proposed regulations is Mitchell H. Rapaport of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

* * * * *

Amendments to the regulations

For the reasons set out in the preamble, Part 1 and Part 602 of Title 26 of the Code of Federal Regulations are amended as follows:

PART 1
INCOME TAX REGULATIONS

Paragraph 1. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805. * * * Section 1.25-4T also issued under 26 U.S.C. 25(g).* * *

Par. 2. Paragraphs (e) and (f) of §1.25-4T are revised to read as follows:

§1.25-4T Qualified mortgage credit certificate program.

* * * * *

(e) *Information reporting requirement*—(1) *Reports.* With respect to mortgage credit certificates issued after September 30, 1985, a program meets the requirements of this paragraph only if the issuer submits a report containing the information concerning the holders of certificates issued during the preceding reporting period required by this paragraph. The report must be filed for each reporting period in which certificates (other than transferred certificates) are issued under the program. The issuer is not responsible for false information provided by a holder if the issuer did not know or have reason to know that the information was false. The report must be filed on the form prescribed by the Internal Revenue Service. If no form is prescribed, or if the form prescribed is not readily available, the issuer may use its own form provided that such form is in the format set forth in this paragraph and contains the information required by this paragraph. The report must be titled "Mortgage Credit Certificate Information Report" and must include the name, address, and TIN of the issuer, the reporting period for which the information is provided, and the following tables containing information concerning the holders of certificates issued during the reporting period for which the report is filed:

(i) A table titled "Number of Mortgage Credit Certificates by Income and Acquisition Cost" showing the number of mortgage credit certificates issued (other than those issued in connection with qualified home improvement and rehabilitation loans) according to the annualized gross income of the holders (categorized in the following intervals of income: $0-$9,999; $10,000-$19,999; $20,000-$29,999; $30,000-39,999; $40,000-$49,999; $50,000-$74,999; and $75,000 or more) and according to the acquisition cost of the residences acquired in connection with the mortgage credit certificates (categorized in the following intervals of acquisition cost: $0-$19,999; $20,000-$39,999; $40,000-$59,999; $60,000-$79,999; $80,000-$99,999; $100,000-$119,999; $120,000-$149,999; $150,000-$199,999; and $200,000 or more). For each interval of income and acquisition cost the table must also be categorized according to—

(A) The aggregate amount of fees charged to holders to cover any administrative costs incurred by the issuer in issuing mortgage credit certificates, and

(B) The number of holders that—

(1) Did not have a present ownership interest in a principal residence at any time during the 3-year period ending on the date the mortgage credit certificate is executed (*i.e.*, satisfied the 3-year requirement) and purchased residences in targeted areas,

(2) Satisfied the 3-year requirement and purchased residences not located in targeted areas,

(3) Did have a present ownership interest in a principal residence at any time during the 3-year period ending on the date the mortgage credit certificate is executed (*i.e.*, did not satisfy the 3-year requirement) and purchased residences in targeted areas, and

(4) Did not satisfy the 3-year requirement and purchased residences not located in targeted areas.

(ii) A table titled "Volume of Mortgage Credit Certificates by Income and Acquisition Cost" containing data on—

(A) The total of the certified indebtedness amounts of the certificates issued (other than those issued in connection with qualified home

improvement and rehabilitation loans);

(B) The sum of the products of the certified indebtedness amount and the certificate credit rate for each certificate (other than those issued in connection with qualified home improvement and rehabilitation loans) according to annualized gross income (categorized in the same intervals of income as the preceding table) and according to the acquisition cost of the residences acquired in connection with mortgage credit certificates (categorized in the same intervals of acquisition cost as the preceding table); and

(C) For each interval of income and acquisition cost, the information described in paragraph (e)(1)(ii)(A) and (B) categorized according to the holders that—

(1) Satisfied the 3-year requirement and purchased residences in targeted areas,

(2) Satisfied the 3-year requirement and purchased residences not located in targeted areas,

(3) Did not satisfy the 3-year requirement and purchased residences in targeted areas, and

(4) Did not satisfy the 3-year requirement and purchased residences not located in targeted areas.

(iii) A table titled "Mortgage Credit Certificates for Qualified Home Improvement and Rehabilitation Loans" showing the number of mortgage credit certificates issued in connection with qualified home improvement loans and qualified rehabilitation loans, the total of the certified indebtedness amount with respect to such certificates, and the sum of the products of the certified indebtedness amount and the certificate credit rate for each certificate; the information contained in the table must also be categorized according to whether the residences with respect to which the certificates were provided are located in targeted areas.

(2) *Format.* If no form is prescribed by the Internal Revenue Service, or if the prescribed form is not readily available, the issuer must submit the report in the format specified in this paragraph (e)(2). The specified format of the report is the following:

MORTGAGE CREDIT CERTIFICATE INFORMATION REPORT

Name of issuer:
Address of issuer:
TIN of issuer:
Reporting period:

NUMBER OF MORTGAGE CREDIT CERTIFICATES BY INCOME AND ACQUISITION COST

3-year Requirement:	*Satisfied*		*Not Satisfied*		*Totals*	*Fees*
Annualized Gross Monthly Income or Borrowers	Nontargeted Area	Targeted Area	Nontargeted Area	Targeted Area		
$ 0 - 9,999						
$10,000 - 19,999						
$20,000 - 29,999						
$30,000 - 39,999						
$40,000 - 49,999						
$50,000 - 74,999						
$75,000 or more						
Total						
Acquisition Cost						
$ 0 - 19,999						
$ 20,000 - 39,999						
$ 40,000 - 59,999						
$ 60,000 - 79,999						
$ 80,000 - 99,999						
$100,000 - 119,999						
$120,000 - 149,999						
$150,000 - 199,999						
$200,000 or more						
Total						

VOLUME OF MORTGAGE CREDIT CERTIFICATES BY INCOME AND ACQUISITION COST

	Holders Satisfying the 3-year Requirement				*3-year Requirement Not Satisfied*				*Totals*	
	Nontargeted Areas		*Targeted Area*		*Nontargeted Area*		*Targeted Area*			
Annualized Gross Monthly Income of Holders	Total of the Certified Indebtedness Amounts	Sum of Products of Certified Indebtedness Amounts and Credit Rates	Total of the Certified Indebtedness Amounts	Sum of Products of Certified Indebtedness Amounts and Credit Rates	Total of the Certified Indebtedness Amounts	Sum of Products of Certified Indebtedness Amounts and Credit Rates	Total of the Certified Indebtedness Amounts	Sum of Products of Certified Indebtedness Amounts and Credit Rates	Total Certified Indebtedness Amounts	Total Sum of Products of Certified Indebtedness Amounts and Credit Rates
$ 0 - 9,999										
$10,000 - 19,999										

$20,000 - 29,999	
$30,000 - 39,999	
$40,000 - 49,999	
$50,000 - 74,999	
$75,000 or more	
Total	
Acquisition Cost	
$ 0 - 19,999	
$ 20,000 - 39,999	
$ 40,000 - 59,999	
$ 60,000 - 79,999	
$ 80,000 - 99,999	
$100,000 - 199,999	
$120,000 - 149,999	
$150,000 - 199,999	
$200,000 or more	
Total	

MORTGAGE CREDIT CERTIFICATES FOR QUALIFIED HOME IMPROVEMENT AND REHABILITATION LOANS

	Nontargeted Area	Targeted Area	Totals
Home Improvement Loans			
Number of mortgage credit certificates			
Total of certified indebtedness amounts			
Product of certified indebtedness amounts and credit rates			
Rehabilitation Loans			
Number of Mortgage credit certificates			
Total of the certified indebtedness amounts			
Product of certified indebtedness amounts and credit rates			

(3) *Definitions and special rules.* (i) For purposes of this paragraph the term "annualized gross income" means the borrower's gross monthly income multiplied by 12. Gross monthly income is the sum of monthly gross pay, any additional income from investments, pensions, Veterans Administration (VA) compensation, part-time employment, bonuses, dividends, interest, current overtime pay, net rental income, etc., and other income (such as alimony and child support, if the borrower chooses to disclose such income). Information with respect to gross monthly income may be obtained from available loan documents, *e.g.*, the sum of lines 23D and 23E on the Application for VA or FmHA Home Loan Guaranty or for HUD/FHA Insured Mortgage (VA Form 26-1802a, HUD 92900, Jan. 1982), or the total line from the Gross Monthly Income section of FHLMC Residential Loan Application form (FHLMC 65 Rev. 8/78).

(ii) For purposes of this paragraph, the term "reporting period" means each one year period beginning July 1 and ending June 30, except that issuers need not provide data with respect to the period prior to October 1, 1985.

(iii) For purposes of this paragraph, verification of information concerning a holder's gross monthly income by utilizing other available information concerning the holder's income (*e.g.*, Federal income tax returns) is not required. In determining whether the holder of a mortgage credit certificate acquiring a residence in a targeted area satisfies the 3-year requirement, the issuer may rely on a statement signed by the holder.

(4) *Time for filing.* The report required by this paragraph shall be filed not later than the 15th day of the second calendar month after the close of the reporting period. The Commissioner may grant an extension of time for the filing of a report required by this paragraph if there is reasonable cause for the failure to file such report in a timely fashion. The report may be filed at any time before such date but must be complete based on facts and reasonable expectations as of the date the report is filed. The report need not be amended to reflect information learned subsequent to the date of filing, or to reflect changed circumstances with respect to any holder.

(5) *Place for filing.* The report required by this paragraph is to be filed at the Internal Revenue Service Center, Philadelphia, Pennsylvania 19255.

(f) *Policy statement.* A program established pursuant to an election under paragraph (c) made after 1984 meets the requirements of this paragraph only if the applicable elected representative of the governmental unit—

(1) Which is the issuer, or

(2) On whose behalf the certificates were issued,

has published (after a public hearing following reasonable public notice) a policy statement described in §1.103A-2(1) by the last day of the year preceding the year in which the election under paragraph (c) is made, and a copy of such report has been submitted to the Commissioner on or before such last day. See §1.103A-2(1) for further definitions and requirements.

* * * * *

PART 602
OMB CONTROL NUMBER UNDER THE PAPERWORK REDUCTION ACT

Par. 3. Section 602.101(c) is amended by inserting in the appropriate

places in the table "§1.25-4T.... 1545-0922".

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

JAMES I. OWENS,
Commissioner of Internal Revenue.

Approved August 19, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 29, 1985, 10:53 a.m., and published in the issue of the Federal Register for September 3, 1985, 50 F.R. 35536)

Subpart D.—Business Related Credits

Section 38.—General Business Credit

26 CFR 1.38-1: Investment in certain depreciable property.

Whether oil lease and well equipment such as casing, tubing, pumps, motors, separators and storage tanks installed on an oil track is a single unit of constructed section 38 property. See Rev. Rul. 85-156, page 11.

Subpart E.—Rules for Computing Credit for Investmennt in Certain Depreciable Property

Section 46.—Amount of Credit

26 CFR 1.46-1: Determination of amount.

Whether oil lease and well equipment such as casing, tubing, pumps, motors, separators and storage tanks installed on an oil tract is a single unit of constructed section 38 property. See Rev. Rul. 85-156, page 11.

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26 CFR 1.46-4: Limitations with respect to certain persons.

Investment credits; cooperative. A cooperative association may have unused investment credit for carryback and carryover purposes in a year during which it has a net operating loss if it acquired and placed in service section 38 property during that year. Rev. Rul. 70-328 revoked.

Rev. Rul. 85-126

ISSUE

The Internal Revenue Service has reconsidered Rev. Rul. 70-328, 1970-1 C.B. 5, which concludes that a cooperative association has no unused investment credit for carryback and carryover purposes in a year during which it has a net operating loss even though it acquired and placed in service section 38 property during that year.

LAW AND ANALYSIS

Section 46(d) of the Internal Revenue Code, prior to amendment by the Tax Reduction Act of 1975, Pub. L. 94-12, 1975-1 C.B. 545, and the Revenue Act of 1978, Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, contained a special limitation on the availability of investment credits to cooperatives. (The 1975 amendment redesignated section 46(d) as section 46(e), and the 1978 amendment repealed the limitation.) The investment credit of a cooperative was limited to its "ratable share" of the credit otherwise allowable. "Ratable share" for a taxable year was defined as fraction, the numerator of which was the cooperative's taxable income and the denominator of which was the cooperative's taxable income plus special deductions allowed the cooperative solely because of its status as a cooperative (generally, deductions for patronage dividends and nonpatronage distributions under section 1382(b) and (c), respectively).

Rev. Rul. 70-328 concludes that a cooperative's ratable share of investment credit is zero in a year when it has a net operating loss and pays no patronage dividends or nonpatronage distributions, so it has no unused investment credit for that year to be carried back or carried over to other taxable years. This conclusion is based on the belief that a cooperative has zero (not negative) taxable income in a loss year, and "[i]f a cooperative has no taxable income, a zero as the numerator of the above ratio automatically yields a zero ratable share...."

The Service's position that a cooperative's ratable share of investment credit is zero in a year when it has a loss or no taxable income and pays no patronage dividends or nonpatronage distributions was upheld in *Farmers Union Marketing & Processing Ass'n v. United States*, Civil No. 73-230 (D. Minn., February 1, 1977), and *Helena Cotton Oil Co. v. Commissioner*, 60 T.C. 125 (1973). However, the Service's position was rejected in *Farm Bureau Services, Inc. v. United States*, 547 F. Supp. 1279 (W.D. Mich. 1982), and *Farmers Grain Marketing Terminal (AAL) v. United States*, 434 F. Supp. 368 (N.D. Miss. 1977), *aff'd per order*, No. 77-2715 (5th Cir. 1980), each concluding that a farmers cooperative is not precluded from claiming an investment credit for property otherwise qualified merely because it places that property in service during a loss year, if it does not pay patronage dividends or nonpatronage distributions in that year.

The courts in *Farm Bureau Services, Inc.* and *Farmers Grain Marketing Terminal* relied on the legislative history of the ratable share formula, which suggests that the formula should restrict the investment credit otherwise allowable to a cooperative only in the proportion its taxable income is reduced by the special deductions available to cooperatives. *See* H.R. Rep. No. 95-1800, 95th Cong., 2d Sess. 228 (1978), 1978-3 (Vol. 1) C.B. 521, 562 (conference report statement with respect to repeal of cooperative ratable share limitation); H.R. Rep. No. 1447, 87th Cong., 2d Sess. 15 (1962), 1962-3 C.B. 402, 419; S. Rep. No. 1881, 87th Cong., 2d Sess. 20, 1962-3 C.B. 703, 726. In view of this legislative history, the courts held that a cooperative's investment credit should not be limited by the ratable share formula in a year when it has no special deductions.

HOLDING

A cooperative association may have unused investment credit for carryback and carryover purposes in a year during which it has a net operating loss if it acquired and placed in service section 38 property during that year.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 70-328 is revoked.

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26 CFR 1.46-4: Limitations with respect to certain persons.

Limitations on the investment credit with re-

spect to noncorporate lessors. See T.D. 8031, page 13.

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26 CFR 1.46-11: Commuter highway vehicles. (Also Section 47; 1.47-1.)

T.D. 8035

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, SUBCHAPTER H, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Investment Credit for Commuter Highway Vehicles

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to special rules for computing the investment credit for commuter highway vehicles. The Energy Tax Act of 1978 (Pub. L. 95-618, 92 Stat. 3193) [1978-3 C.B. (Vol. 2) 1] enacted special rules for determining the amount of that credit and for the recapture of that credit. The regulations provide the public and Internal Revenue Service personnel with the guidance needed to comply with and administer the law.

DATES: The amendments are effective for commuter highway vehicles placed in service on or after November 9, 1978 and before January 1, 1986.

FOR FURTHER INFORMATION CONTACT: Patricia Wendlandt of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (202-566-3458, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains final amendments to the Income Tax Regulations (26 CFR Part 1) under sections 46(c)(6) and 47(a)(4) of the Internal Revenue Code of 1954, relating to the investment credit for commuter highway vehicles. These regulations were published in proposed form in the FEDERAL REGISTER on October 5, 1984 (49 FR 39344) [LR-169-79, 1984-2 C.B. 833]. One comment was received suggesting changes to the proposed amendments to the regulations. There were no requests for a public hearing and none was held. With only minor revisions, the proposed regulations are adopted by this Treasury decision.

COMMUTER USE REQUIREMENT

The proposed regulations define the 80 percent commuter use requirement. To qualify for the investment credit for commuter highway vehicles, section 46(c)(6)(B)(ii) and the regulations provide that at least 80 percent of the vehicle's mileage must be for purposes of transporting the taxpayer's employees between their residences and their places of employment. The comment suggested that personal incentive mileage and mileage for maintenance and refueling be included as qualified commuter uses. Such usage is not considered to be for the purpose of transporting the taxpayer's employees between their residences and places of employment and is not properly considered a qualified commuter use of the vehicle. Although personal incentive mileage and mileage for maintenance and refueling are not includible as qualified commuter uses, such mileage will not disqualify a commuter highway vehicle provided it does not exceed 20 percent of the vehicle's total mileage. Accordingly, the final regulations adopt the proposed definition of the commuter use and requirement without change.

EXECUTIVE ORDER 12291 AND REGULATORY FLEXIBILITY ACT

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although a notice of proposed rulemaking that solicited public comment was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 did not apply. Accordingly, the final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

PAPERWORK REDUCTION ACT

The collection of information requirements contained in these regulations have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these final regulations is Patricia Wendlandt of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

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Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 and Part 602 are amended as follows:

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Paragraph 1. These regulations are issued under the authority contained in 26 U.S.C. 7805 and 26 U.S.C. 47(a). The authority citation for Part 1 is amended by adding "§1.47-1 also issued under 26 U.S.C. 47(a)."

Par. 2. A new §1.46-10 is added in the appropriate place to read "§1.46-10 [Reserved]."

Par. 3. A new §1.46-11 is added in the appropriate place. As added, the new section reads as follows:

§1.46-11 Commuter highway vehicles.

(a) *In general.* Section 46(c)(6) provides that the applicable percentage to determine qualified investment under section 46(c)(1) for a qualifying commuter highway vehicle is 100 percent. A qualifying commuter highway vehicle is a vehicle (defined in paragraph (b) of this section)—

(1) Which is acquired by the taxpayer on or after November 9, 1978,

(2) Which is placed in service by the taxpayer before January 1, 1986, and

(3) With respect to which the taxpayer makes an election under paragraph (g) of this section.

(b) *Definition of commuter highway vehicle.* A commuter highway vehicle is a highway vehicle that meets the following requirements:

(1) The vehicle is section 38 property in the hands of the taxpayer. The rule of section 48(d), allowing a lessor to elect to treat the lessee of new section 38 property as having acquired the property, applies to commuter highway vehicles. If the vehicle is leased and that election is made, the lessee is treated as the taxpayer under this section. However, if that election is not made, the lessor, and not the lessee, is treated as the taxpayer under this section.

(2) The vehicle must meet the seating capacity requirement of paragraph (c) of this section; and

(3) The taxpayer reasonably expects to meet the commuter use requirement of paragraph (d) of this section for at least the first 36 months after the vehicle is placed in service.

(c) *Seating capacity.* A commuter highway vehicle must have a seating capacity of at least 8 adults in addition to the driver's seat.

(d) *Commuter use requirement.* A vehicle meets the commuter use requirement only if at least 80 percent of the miles the vehicle is driven are for trips to transport the taxpayer's employees between their residences and their places of employment. A trip for this purpose includes driving the vehicle before or after employees are in the vehicle, so long as the mileage driven is necessary either to pick up or drop off passengers or to park the vehicle in its regular parking space. A trip does not include miles driven solely for maintenance or to refuel the vehicle. A trip is not considered to transport the taxpayer's employees between their residences and their places of employment unless at least one-half the seating capacity (defined in paragraph (c) of this section) is used to seat employees of the taxpayer. In no event is the driver counted as an employee of the taxpayer.

(e) *Definition of employee.* An employee in this section is the same as in section 3121(d) (definition of employee for withholding purposes).

(f) *Transportation between employee's residence and place of employment.* An employee is transported between that employee's residence and place of employment even if that place of employment is not the same as any of the other employees transported, and even if picked up or dropped off at some central point between that residence and place of employment. An employee is not transported between that employee's residence and place of employment if the transportation is of the type for which a deduction would be allowed under §1.162-2 were the employee providing it, such as the transportation from one work site to another after beginning work for the day.

(g) *Election.* A taxpayer must elect to have the vehicle treated as a qualifying commuter highway vehicle on the return for the taxable year in which the vehicle is placed in service. The election may be made only if the vehicle actually meets the commuter use requirement under paragraph (d) of this section for that taxable year. It must be made on or before the due date (including extensions) of that return. The election is effective as of that due date.

Par. 4. Section 1.47-1 is amended by:

1. Inserting, in the first sentence of paragraph (a)(1)(i) of that section, "or is a qualifying commuter highway vehicle (as defined in paragraph (a) of §1.46-11) which undergoes a change in use (as defined in paragraph (m)(2) of this section)" immediately following "(as defined in paragraph (g) of §1.46-3)", and

2. Reserving paragraphs (i), (j), (k), and (l) and by adding a new paragraph (m) to read as follows:

§1.47-1 Recomputation of credit allowed by section 38.

* * * * *

(i) [Reserved].

(j) [Reserved].

(k) [Reserved].

(l) [Reserved].

(m) *Commuter highway vehicles*—(1) *Recomputed qualified investment.* (i) If a qualifying commuter highway vehicle (as defined in §1.46-11(a)) undergoes a change in use but does not cease to be section 38 property, qualified investment for that vehicle is recomputed as if the vehicle was section 38 property which is not a qualifying commuter highway vehicle for its entire useful life.

(ii) The following example illustrates this paragraph (m)(1).

Example. X Corporation, a calendar year taxpayer, acquired and placed in service on January 1, 1982, a qualifying commuter highway vehicle with a basis of $10,000 and which qualified as three year recovery property under section 168(c)(2)(A)(i). The amount of qualified investment for the vehicle under section 46(c)(1) and (6) is $10,000. For the taxable year 1982, X Corporation's credit earned was $1,000 (10 percent of $10,000) and X Corporation was allowed under section 38 a $1,000 credit against its 1982 tax liability. During the taxable year 1984, the vehicle undergoes a change in use but does not cease to be section 38 property. The vehicle is treated as section 38 property which is not a qualifying commuter highway vehicle of its entire useful life. The recomputed qualified investment for the vehicle is $6,000 (60 percent of $10,000) and X Corporation's recomputed credit earned is $600 (10 percent of $6,000). The income tax imposed by chapter 1 of the Code on X Corporation for 1984 is increased by the $400 decrease in its credit earned for 1982 ($1,000–$600).

(2) *Change in use*—(i) A qualifying commuter highway vehicle undergoes a change in use if the vehicle does not meet the commuter use requirement (as defined in §1.46-11(d)) for each computation period.

(ii) Each of the following is a computation period:

(A) The period beginning on the date the vehicle was placed in service and ending on the last day of the taxpayer's taxable year in which the vehicle was placed in service;

(B) Each of the taxpayer's taxable years beginning after the date the vehicle was placed in service and ending before the end of the first 36 months after the vehicle was placed in service; and

(C) The period ending at the end of the first 36 months after the vehicle was placed in service and beginning on the first day of the taxpayer's taxable year in which the end of those first 36 months falls.

(iii) The following example illustrates this paragraph (m)(2).

Example (1). (a) Z Corporation, a calendar year taxpayer, acquired and placed in service a qualifying commuter highway vehicle on January 15, 1979. Z Corporation used the vehicle as set forth in the following table:

Taxable year ending	Total miles	Commuter miles	Ratio
1979	10,000	9,000	.90
1980	10,000	8,000	.80
1981	10,000	8,000	.80
1982 (1–14) ...	1,000	100	.10

(b) The first computation period begins on the date the vehicle is placed in service, in this example 1–15–79, and ends 12–31–79. In that computation period, the ratio of commuter miles to total miles is .90 (9,000 mile ÷ 10,000 miles). Therefore, the vehicle meets the commuter use requirement for that period and has not undergone a change in use. Similar calculating for the computation periods 1–1–80 to 12–31–80 and 1–1–81 to 12–31–81 produce the same result.

(c) As of the computation period beginning 1–1–82 and ending 1–14–82, the ratio of commuter use to total mileage is .10 (100 miles ÷ 1,000 miles). Since that ratio is less than .80, the vehicle does not meet the commuter use requirement for the period and the vehicle has undergone a change in use.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 5. The authority citation for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 6. Section 602.101(c) is amended by inserting in the appropriate place in the table "§1.46-11(g) . . . 1545-0155"

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved June 17, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 18, 1985, 8:45 a.m., and published in the issue of the Federal Register for July 19, 1985, 50 F.R. 29369)

Section 47.—Certain Dispositions, Etc., of Section 38 Property

26 CFR 1.47-1: Recomputation of credit allowed by section 38.

Whether oil lease and well equipment such as casing, tubing, pumps, motors, separators and storage tanks installed on an oil tract is a single unit of constructed section 38 property. See Rev. Rul. 85-156, page 11.

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26 CFR 1.47-1: Recomputation of credit allowed by section 38.

Special rules for computing the investment credit for commuter highway vehicles. See T.D. 8035, page 6.

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26 CFR 1.47-3: Exceptions to the application of section 1.47-1.

Investment credit; recapture; transfer of property to partnership; simultaneous leaseback. If section 38 property is contributed to a partnership and simultaneously leased back to the taxpayer making the contribution, there is no recapture of investment tax credit under section 47 of the Code.

Rev. Rul. 85-179

ISSUE

Under the circumstances described below, is there recapture of investment tax credit under section 47 of the Internal Revenue Code at the time section 38 property is contributed to a partnership and simultaneously leased back to the taxpayer making the contribution?

FACTS

The taxpayer is a corporation engaged in the manufacture and sale of industrial lubricating systems. Most of the machinery and equipment it uses in its manufacturing operations qualifies as section 38 property. The taxpayer has claimed investment tax credit with respect to this section 38 property.

X is a limited partnership engaged in a variety of activities, including the ownership and operation of railroad boxcars. In order to broaden *X*'s capital base and further diversify its operations, the partners of *X* solicited additional investment in the partnership. The taxpayer contributed a significant amount of the section 38 property that it uses in its manufacturing operations to *X* in exchange for a 9 percent interest in the partnership's profits and losses. The section 38 property was simultaneously leased back to the taxpayer at a fair rental value for a term substantially less than the useful life of the property. The taxpayer had no option to repurchase the property.

LAW AND ANALYSIS

Section 47(a)(1) of the Code provides that if during any taxable year any property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, before the close of the useful life that was taken into account in computing the credit under section 38, then the tax for the taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years that would have resulted solely from substituting, in determining qualified investment, for the useful life the period beginning with the time the property was placed in service by the taxpayer and ending with the time the property ceased to be section 38 property. The legislative history of section 47 indicates that its purpose is to prevent a quick turnover of assets in an effort by a taxpayer to obtain multiple tax credits. *See* H.R. Rep. No. 1447, 87th Cong., 2d Sess. 13 (1962), 1962-3 C.B. 405, 417.

Section 1.47-2(a)(1) of the Income Tax Regulations provides that the term "disposition" includes a sale in a sale-and-lease back transaction. The term "disposition" also includes events not specifically mentioned in the regulations, such as a contribution to a partnership. *See* H.R. Rep. No. 1447 at A12, 1962-3 C.B. at 510.

Section 1.47-3(g) of the regulations provides that notwithstanding the provisions of section 1.47-2 relating to "disposition" and "cessation," the rules requiring recapture shall not apply where section 38 property is disposed of and as part of the same transaction is leased back to the vendor even though gain or loss is recognized to the vendor-lessee and the property ceases to be subject to depreciation in the vendor-lessee's hands. Thus, the present situation falls within the scope of the exception to the recapture rules provided by section 1.47-3(g).

HOLDING

Under the circumstances described above, there is no recapture of investment tax credit under section 47 of the Code at the time section 38 property is contributed to a partnership and simultaneously leased back to the taxpayer making the contribution.

Section 48—Definition; Special Rules

26 CFR 1.48-1: Definition of section 38 property.

Investment credit; hydraulic dock

leveler. A hydraulic dock leveler that is bolted to the loading dock and used in the operation and maintenance of an office building is a structural component of a building within the meaning of section 1.48-1(e)(2) of the regulations and does not qualify as section 38 property

Rev. Rul. 85-90

ISSUE

Whether the hydraulic dock leveler described below qualifies as section 38 property for purposes of the investment tax credit.

FACTS

In 1983, the taxpayer constructed a new office building equipped with a hydraulic dock leveler that is bolted to the loading dock. The dock leveler is an adjustable ramp that serves to bridge the gap between the dock and the truck and compensates for variances in the height of truck beds. The leveler weighs approximately 2000 pounds, has a 25,000 pound load bearing capacity and consists of a 6×8 foot steel platform deck and a hydraulic system that raises and lowers the deck at one end. The pressure for the hydraulic system is provided by an electrically driven pump. The dock leveler is recovery property under section 168 of the Internal Revenue Code.

LAW AND ANALYSIS

Section 38 of the Code allows a credit against federal income tax for qualified investment in section 38 property. Section 38 property is defined in section 48.

Section 48(a)(1) of the Code defines section 38 property to include (A) tangible personal property or (B) other tangible property (not including a building and its structural components) but only if the other tangible property is used as an integral part of manufacturing, production, or other specified activity. The term section 38 property includes only recovery property (without regard to any useful life) and any other property with respect to which depreciation is allowable that has a useful life of 3 years or more.

Section 1.48-1(c) of the Income Tax Regulations provides that the term "tangible personal property" means any tangible property except land and improvements thereto, such as buildings or other inherently permanent structures. The term includes all property (other than structural components) that is contained in or attached to a building and all property that is in the nature of machinery (other than structural components of a building or other inherently permanent structures) even though located outside a building. Thus, for example, a gasoline pump, hydraulic car lift, or automatic vending machine, although annexed to the ground, shall be considered tangible personal property.

Section 1.48-1(e)(1) of the regulations provides that buildings and structural components thereof do not qualify as section 38 property.

Section 1.48-1(e)(2) of the regulations defines the term "structural components." The term includes such parts of a building as walls, partitions, floors and ceilings; windows and doors; all components of a central air-conditioning or heating system; plumbing and plumbing fixtures; electric wiring and lighting fixtures; escalators and elevators and other components relating to the operation or maintenance of a building.

The dock leveler is an important truck loading area accessory. Because the dock leveler is permanently installed and is used in the operation and maintenance of the office building, it is a structural component of a building within the meaning of section 1.48-1(e)(2) of the regulations. It is not, therefore, tangible personal property or qualifying other tangible property.

HOLDING

The hydraulic dock leveler described in the facts is a structural component of a building within the meaning of section 1.48-1(e)(2) of the regulations and does not qualify as section 38 property.

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26 CFR 1.48-1: Definition of section 38 property.

Investment credit; section 38 property; snowmaking system. Components of a snowmaking system such as air and water distribution pipes, hydrants, electrical transmission lines, and a water intake pipe are not section 38 property and do not qualify for the investment credit.

Rev. Rul. 85-93

ISSUE

Are various components of a snowmaking system used by a taxpayer in the operation of its ski resort section 38 property within the meaning of section 1.48-1 of the Income Tax Regulations?

FACTS

The taxpayer operates a ski resort. It also owns and operates a snowmaking system that produces snow used on the ski slopes and trails.

The system operates through the use of water pumps, air compressors, power transformers, and other machinery, which are housed adjacent to the water source, a large pond. Water is pumped through welded steel pipe from the pond, up the nearby ski slopes, and along the ski trails. Almost all the pipe is buried for insulation, safety, or aesthetic purposes. High voltage electrical transmission lines to the pumphouse are also buried as required by state and local law. Other welded steel pipe, buried in the same trenches with the water lines, carries compressed air from an air compressor located in the pumphouse. The water and air distribution lines are tapped at appropriate intervals along the slopes and trails by upright pipes and valves. Flexible hoses connected to these hydrants deliver the water and air to the guns through which the water is ejected and atomized by a jet of the compressed air. When the guns are operated in temperatures of less than 32 degrees Fahrenheit, the spray freezes and falls as snow along the slopes and trails, all of which are a part of the taxpayer's ski resort. (No snow is sold to other parties.)

The taxpayer and the Service agree that the pumphouse is a building and not section 38 property. It is also agreed that the snowmaking guns and hoses, power transformers, pumps, compressors, control equipment, and plumbing and wiring interconnections in and around the pumphouse are all in the nature of machinery and are, therefore, tangible personal property qualifying as section 38 property. The only

snowmaking system components at issue in this revenue ruling are the air and water distribution pipes, the hydrants, the electrical transmission lines and the water intake pipe.

LAW AND ANALYSIS

Section 38 of the Internal Revenue Code allows a credit against federal income tax for qualified investments. Section 48 and the corresponding regulations define what property qualifies under section 38.

Section 48(a)(1) of the Code provides that the term "section 38 property" includes: (1) tangible personal property, and (2) other tangible property (not including a building and its structural components) if such property is used as an integral part of one of certain specific activities among which are manufacturing and production.

Section 1.48-1(c) of the regulations provides that, for investment credit purposes, the term "tangible personal property" means any tangible property except land and improvements thereto, such as buildings or other inherently permanent structures (including items which are structural components of such buildings or structures). Tangible personal property includes all property (other than structural components) which is contained in or attached to a building. Furthermore, all property which is in the nature of machinery (other than structural components of a building or other inherently permanent structure) shall be considered tangible personal property even though located outside a building.

Section 1.48-1(d)(2) of the regulations provides that, for investment credit purposes, the terms "manufacturing" and "production" include the construction, reconstruction, or making of property out of scrap, salvage, or junk material, as well as from new or raw material, by processing, manipulating, refining, or changing the form of an article, or by combining or assembling two or more articles.

The snowmaking system components in question—the air and water distribution pipes, the hydrants, the electrical transmission lines, and the water intake pipe—may qualify as section 38 property if they are either tangible personal property or are used as an integral part of manufacturing or production.

The committee reports prepared when the investment credit was first enacted mention oil and gas pipelines as examples of real property. H.R. Rep. No. 1447, 87th Cong., 2d Sess. 12 (1962), 1962-3 C.B. 405, 416; S. Rep. No. 1881, 87th Cong., 2d Sess. 16 (1962), 1962-3 C.B. 707, 722. Because they are analogous to oil and gas pipelines, extensive systems of underground piping are considered inherently permanent improvements to land and not tangible personal property. *See, e.g., Johnston v. United States*, 80-1 U.S.T.C. ¶ 9199 (D. Mont. 1979) (underground water and sewer pipes); Rev. Rul. 69-273, 1969-1 C.B. 30 (underground pipes and valves in a golf course irrigation system); Rev. Rul. 66-269, 1966-2 C.B. 13 (underground pipes) in a trailer park water and sewer system), all relying on the oil and gas pipeline analogy.

The air and water distribution pipes and hydrants of the snowmaking system are similar to the types of property involved in the above authorities in that all consist of extensive systems of underground piping connected to machinery or equipment. Accordingly, the air and water distribution pipes and hydrants are not tangible personal property, but are inherently permanent improvements to land.

Electrical wiring and plumbing appurtenant to machinery or equipment are sometimes considered part of the machinery or equipment and, thus, tangible personal property. *See, e.g.*, Rev. Rul. 69-558, 1969-2 C.B. 4; Rev. Rul. 66-299, 1966-2 C.B. 14. In the cited revenue rulings, the electrical wiring and plumbing are located in the immediate vicinity of, and inside the building housing, the machinery to which they are connected.

The water intake pipe and electrical transmission lines of the snowmaking system are located outside the pumphouse and buried underground. Therefore, these components are not tangible personal property, but are inherently permanent property not in the nature of machinery or equipment.

Although none of the components in question are tangible personal property, they may be section 38 property if used as an integral part of manufacturing or production.

As used in section 48(a)(1) of the Code the terms "manufacturing" and "production" are to be given their commonly accepted meanings. H.R. Rep. No. 1447, at A18, 1962-3 C.B. at 516; S. Rep. No. 1881, at 155, 1962-3 C.B. at 859. Interpreting the term "manufacturing" in its usual sense, Rev. Rul. 81-66, 1981-1 C.B. 19, concludes that the operation of a cafeteria is a retail activity, not a manufacturing activity within the meaning of section 48(a)(1), and that leasehold improvements to the cafeteria facility that are not tangible personal property do not qualify as section 38 property. Rev. Rul. 81-66, 1981-1 C.B. at 20, states:

> Activities involving the sale of merchandise, food and other items to the general public for personal or household consumption, and the rendering of services incidental to the sale of goods are considered to be retail activities rather than manufacturing within the commonly accepted meaning of the term. Processing incidental or subordinate to selling is often conducted at retail stores. For example, drug stores prepare prescriptions, restaurants prepare meals, and meat markets cut meat.
>
> The operation of a cafeteria, like the operation of a restaurant or cafe, is considered in the trade to be a retail activity rather than a manufacturing activity. The food and drink prepared by the cafeteria employees is for direct sale to and for the consumption by the general public. The food preparation activity is incidental or subordinate to the selling of the prepared meals and is not considered to be similar to any of the activities encompassed by the definition of manufacturing provided by section 1.48-1(d)(2) of the regulations.

Thus, Rev. Rul. 81-66 determines that in common parlance the term "manufacturing" does not include incidental or subordinate activities occuring in a retail context.

Similarly, the terms "manufacturing" and "production" in their customary sense do not embrace activities that are incidental or subordinate to the provision of recreational services, such as snowmaking by the operator of a ski resort. Accordingly, the air and water distribution pipes, hydrants, electrical transmission lines and the water intake pipe in the present case are not used as

an integral part of manufacturing or production.

HOLDING

The snowmaking system components in question are not section 38 property and do not qualify for the investment credit.

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26 CFR 1.48-1: Definition of section 38 property.
(Also Sections 38, 46, 47; 1.38-1, 1.46-1, 1.47-1.)

Investment credit; oil lease and well equipment. Separate items of oil lease and well equipment such as casing, tubing, pumps, motors, separators and storage tanks must be classified separately as new or used section 38 property.

Rev. Rul. 85-156

ISSUE

Whether oil lease and well equipment such as casing, tubing, pumps, motors, separators and storage tanks installed on an oil tract is a single unit of constructed section 38 property.

LAW AND ANALYSIS

Section 38(a) of the Internal Revenue Code allows a tax credit which section 46(a) provides shall be a percentage of qualified investment. Section 46(c)(1) states that qualified investment means the applicable percentage of the basis of each new section 38 property plus the applicable percentage of the basis of each used section 38 property placed in service during the year.

Section 48(b)(1) of the Code defines new section 38 property as property the original use of which commences with the taxpayer. Section 48(c)(1) defines used section 38 property as section 38 property acquired by purchase after December 31, 1961, which is not new section 38 property. Section 48(c)(2) limits the cost of used section 38 property that may qualify for the credit in any taxable year.

An item of property can be constructed with some used parts yet constitute new section 38 property. *See*, for example, section 1.48-2(b)(3) of the Income Tax Regulations and Rev. Rul. 80-313, 1980-2 C.B. 25. The installation of an item of used property, however, in conjunction with new property or with other items of used property does not necessarily constitute the construction of new property within the meaning of section 48(b) of the Code. Each separate item of property must be separately classified as new or used property.

Oil lease and well equipment is not a single unit of constructed property. Each well contains a number of separate items of section 38 property each of which must be classified as new or used. Although the property placed on an oil well performs a unitary function, in this sense it is not different than the items of machinery and equipment in a factory that are part of a single production line. The items of machinery and equipment do not lose their character as separate items of property for purposes of determining whether they are new or used property merely because they are installed together to accomplish a single objective. For example, a pump used on an oil tract, like a machine in a factory production line, is a separate property.

HOLDING

Separate items of oil lease and well equipment such as casing, tubing, pumps, motors, separators and storage tanks must be classified separately as new or used section 38 property.

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26 CFR 1.48-1: Definition of section 38 property.

Investment credit; boilers fueled by oil or natural gas. A boiler primarily fueled by natural gas used in a residential apartment building is a structural component of a building and does not qualify as section 38 property.

Rev. Rul. 85-183

ISSUE

Does a boiler primarily fueled by natural gas and used in a residential apartment building as part of the heating system of that building qualify as section 38 property?

FACTS

Taxpayer constructed and placed in service a residential apartment building in 1982. The building contained a central heating system that provides steam heat to each apartment unit. Included in the heating system is a boiler primarily fueled by natural gas.

LAW AND ANALYSIS

Section 48(a)(1) of the Code provides that the term "section 38 property" includes (A) tangible personal property or (B) other tangible property (not including a building and its structural components) but only if the other tangible property is used as an integral part of certain specified activities.

Section 48(a)(10)(A) of the Code provides that the term "section 38 property" does not include any boiler primarily fueled by petroleum or petroleum products (including natural gas) unless the use of coal is precluded by federal air pollution regulations (or by state air pollution regulations in effect on October 1, 1978) or unless the use of such boiler will be an exempt use within the meaning of subparagraph (B).

Section 48(a)(10)(B) of the Code defines the term "exempt use" for purposes of subparagraph (A). Included in the definition are such uses as use in an apartment, hotel, motel, office building, a wholesale or retail establishment, and any other facility that is not an integral part of manufacturing, processing, or mining.

Section 1.48-1(e)(1) of the regulations provides that buildings and structural components thereof do not qualify as section 38 property.

Section 1.48-1(e)(2) of the regulations defines the term "structural components". Included in the definition are parts of a building such as all components of a central air conditioning or heating system and other components relating to the operation or maintenance of a building.

The section 1.48-1(e)(2) definition of structural components is based, in part, on the language in the committee reports associated with the Revenue Act of 1962 (Public Law 87-834), which first provided for the investment tax credit. Both H.R. Rep. No. 1447, 87th Cong. 2nd Sess. A18 (1962), 1963-3 C.B. 405, 516 and S. Rep. No. 1881, 87th Cong., 2nd Sess. 155 (1962), 1962-3 C.B. 707, 859, state that the term "structural components" of a building includes such parts of the building as central air-conditioning and

heating systems, plumbing, and electric wiring and lighting fixtures, related to the operation and maintenance of the building.

Section 48(a)(10) of the Code was added by section 301(d) of Title III of the Energy Tax Act of 1978, 1978-3 (Vol. 2) C.B. vii, 20, 26. The subject heading for Title III is "Changes in Business Investment Credit to Encourage Conservation of, or Conversion From, Oil and Gas or to Encourage New Energy Technology". The subject heading for section 301(d) is "Denial of Investment Tax Credit for Certain Property". In addition to denying the investment tax credit for most boilers fueled by oil and gas, section 301(d) denied the investment tax credit for air conditioning or space heating units that may have qualified as tangible personal property under the prior law and denied rapid depreciation for boilers fueled by oil or gas.

The source of the language on exempt uses in section 48(a)(10) was the proposed excise tax on business use of oil and natural gas that was part of the 1977 House Energy Tax Bill (Title II of H.R. 6831). The House bill also proposed to deny investment tax credit for most boilers that are fueled by oil or natural gas except for those boilers used in any of the exempt uses. The excise tax portion of the House bill was not included in the final bill (H.R. 5263) that was enacted into law. See H.R. Rep. No. 95-496, Part III, 95th Cong., 1st Sess. 93, 100-105, 124 (1977), 1978-3 (Vol. 2) C.B. 71, 155, 162-167, 186. See also S. Rep. No. 95-1324 (Conf. Rep.), 95th Cong., 2nd Sess. 59-61, 67 (1978), 1978-3 (Vol. 2) C.B. 309, 331-333, 339.

Section 301(d) of the 1978 Act, which added section 48(a)(10) to the Code, was intended to remove from the definition of section 38 property certain property that could qualify as section 38 property under the prior law. See H.R. Rep. No. 95-496, Part III, 95th Cong., 1st Sess. 5, 124 (1977), 1978-3 (Vol. 2) C.B. 71, 79, 186. The purpose of section 301(d) under Title III is to encourage conservation of, or conversion from oil and gas and not to expand the definition of section 38 property by adding property that uses oil or natural gas that did not qualify for the credit before.

Under section 48(a)(1) of the Code, section 1.48-1(e)(2) of the regulations, and the committee reports associated with the Revenue Act of 1962, cited above, it is clear that parts of a building such as heating systems related to the operation and maintenance of the building are "structural components" of the building that do not qualify as section 38 property. Since the legislative history of section 48(a)(10) of the Code indicates that Congress intended to restrict the definition of section 38 property, structural components that did not qualify as section 38 property prior to the enactment of section 48(a)(10) are not affected by that section.

HOLDING

A boiler primarily fueled by natural gas used in a residential apartment building, is a structural component of a building within the meaning of section 1.48-1(e)(2) of the regulations and does not qualify as section 38 property.

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26 CFR 1.48-1: Definition of section 38 property

Investment credit; energy property; equipment used to produce fuel alcohol from biomass feedstock. Equipment placed in service in 1982 that uses oil or natural gas as a primary source of energy to convert biomass to fuel alcohol qualifies as alternative energy property under section 48(1)(3)(A)(iii) of the Code. Rev. Rul. 85-41 distinguished.

Rev. Rul. 85-191

ISSUE

Whether equipment placed in service in 1982 that uses oil or natural gas as a primary source of energy to convert biomass to fuel alcohol qualifies as energy property under section 48(1) of the Internal Revenue Code.

FACTS

In 1982, taxpayer constructed a new plant to produce fuel alcohol from biomass feedstock. The fuel alcohol is used in the production of gasohol. The primary source of energy for the plant facility is natural gas that is used to fire boilers producing steam for the alcohol production process. The biomass feedstock is an alternate substance under both sections 48(1)(3)(B) and 48(1)(15)(B)(i) of the Code. The fuel alcohol production equipment is recovery property under section 168(c) of the Code. For federal income tax purposes, the only significant difference between the facts in this revenue ruling and those in Rev. Rul. 85-41, 1985-1 C.B. 17, is that the plant facility was constructed and placed in service in 1982 rather than 1984.

LAW AND ANALYSIS

Section 46(a) of the Code provides that, for purposes of section 38, the amount of the investment credit determined under this section for any taxable year shall be an amount equal to the sum of the following percentages of the qualified investment:

(1) the regular percentage,

(2) in the case of energy property, the energy percentage, and

(3) in the case of that portion of the basis of any property which is attributable to qualified rehabilitation expenditures, the rehabilitation percentage.

Section 46(b)(2)(A) of the Code provides a table to be used in determining the applicable investment credit energy percentage for the various categories of energy property. Section 46(b)(2)(A)(I) sets forth a general rule that provides a 10 percent credit, beginning October 1, 1978, and ending December 31, 1982, for property not described in any of the subsequent provisions of the table. Alternative energy property, defined in section 48(1)(3), is not separately described or listed in the subsequent provisions of the section 46(b)(2)(A) table and, therefore, comes under the general rule. On the other hand, biomass property, which is defined in section 48(1)(15), is separately described in section 46(b)(2)(A)(VI). That section provides a ten percent credit for biomass property for the period beginning October 1, 1978, and ending December 31, 1985.

Section 48(1)(3)(A)(iii) of the Code defines the term "alternative energy property" to include equipment for converting an alternate substance into a synthetic liquid, gaseous, or solid fuel. Section 48(1)(3)(B) defines the term "alternative substance" to mean any substance other than oil and natural gas, and any product of oil and natural gas.

Section 1.48-9(c)(5)(i) of the Income Tax Regulations provides that equip-

ment (synthetic fuel equipment) that converts an alternate substance into a synthetic solid, liquid, or gaseous fuel (other than coke or coke gas) is alternative energy property. In the example provided in the regulations, alcohol production equipment qualifies as synthetic fuel equipment to the extent that it is used to produce alcohol for use in a fuel mixture, such as gasohol. Section 1.48-9(c)(5)(iii) provides that synthetic fuel equipment includes equipment that converts biomass into a synthetic fuel.

Section 48(1)(15) of the Code, which was added by section 222(g) of the Crude Oil Windfall Profit Tax Act of 1980, 1980–3 C.B. 1, 36, defines the term "biomass property" to include equipment for converting an alternate substance into alcohol for fuel purposes, but only if the primary source of energy for the facility producing the alcohol is not oil or natural gas or a product of oil or natural gas.

Section 1.48-9(a)(1) of the regulations states that energy property means property described in at least one category of energy property. If property is described in more than one category or is described more than once in a single category, only one energy credit is allowed. If the property is described in more than one category, the credit will be allowed under the category chosen by the taxpayer.

It was possible, prior to January 1, 1983, for certain fuel alcohol production facilities to fall into more than one category of energy property. Any facility that qualified as biomass property under section 48(1)(15) of the Code also qualified as alternative energy property under section 48(1)(3)(A)(iii). However, only if the primary source of energy for the facility producing the alcohol is other than oil or natural gas or a product of oil or natural gas may the alternative energy property qualify as biomass property. A fuel alcohol production facility that does not qualify as biomass property because it uses oil or natural gas as its primary source of energy could, thus, qualify as alternative energy property. The availability of the energy credit for alternative energy property, however, ended on December 31, 1982, while the availability of the energy credit for biomass property does not end until December 31, 1985.

Taxpayer's fuel alcohol production equipment does not qualify as biomass property uner section 48(1)(15) of the Code because it uses natural gas as its primary energy source. However, the equipment qualifies for the energy credit as alternative energy property under section 48(1)(3)(A)(iii) of the Code and section 1.48-9(c)(5)(i) of the regulations because it was placed in service in 1982.

In Rev. Rul. 85-41, equipment similar to that described in this revenue ruling was placed in service on or after January 1, 1983. Since the energy credit for alternative energy property did not still apply, that equipment did not qualify for the energy credit.

HOLDING

Equipment placed in service in 1982 that uses oil or natural gas as a primary source of energy to convert biomass to fuel alcohol qualifies as alternative energy property under section 48(1)(3)(A)(iii) of the Code and section 1.48-9(c)(5)(i) of the regulations.

EFFECT ON OTHER RULINGS

Rev. Rul. 85-41 is distinguished.

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26 CFR 1.48-1: Definition of section 38 property.
(Also Section 46; 1.46-4.)

T.D. 8031

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Investment Tax Credit for Qualified Rehabilitated Buildings

AGENCY: Internal Revenue Service, Treasury.
ACTION: Final Regulations.

SUMMARY: This document contains final Income Tax Regulations relating to the investment tax credit for qualified rehabilitated buildings. It reflects changes relating to the rehabilitation credit that were made to sections 38, 46, 47 and 48 of the Internal Revenue Code of 1954 by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1] and the Technical Corrections Act of 1979 [Pub. L. 96-222, 1980-1 C.B. 499], but does not reflect changes made to those sections by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256]. Given the fact that the Economic Recovery Tax Act of 1981 substantially amended the provisions pertaining to the rehabilitation credit, these regulations are generally not effective for expenditures incurred after December 31, 1981. A notice of proposed rulemaking * * * [LR-238-81, page 777, this Bulletin] however, contains proposed regulations relating to these expenditures.

DATES: The amendments are generally effective with respect to qualified rehabilitation expenditures incurred after October 31, 1978, and before January 1, 1982.

FOR FURTHER INFORMATION CONTACT: John G. Schmalz of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. Attention CC:LR:T, (202-566-3516, not a toll free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On October 28, 1980, the FEDERAL REGISTER published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 46 and 48 of the Internal Revenue Code of 1954. The amendments were proposed to conform the regulations to section 315 of the Revenue Act of 1978 (92 Stat. 2828) [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 62] and section 103(a)(4) of the Technical Corrections Act of 1979 (94 Stat. 209) [Pub. L. 96-222, 1980-1 C.B. 499, 507].

Public comments on the proposed regulations were received. A public hearing was held on March 31, 1981. After consideration of all comments regarding the proposed amendments, these amendments are adopted as revised by this Treasury decision.

EXPLANATION OF PROVISIONS

Under section 48(a)(1)(E), that portion of the basis of a qualified rehabilitated building which is attributable to qualified rehabilitation expenditures is treated as section 38 property. Section 48(g)(1) and (2) and the final regulations set forth several requirements

for qualified rehabilitated buildings and for qualified rehabilitation expenditures.

One requirement for a qualified rehabilitated building is that a twenty-year period must have elapsed between the beginning of the rehabilitation and the later of: (1) the date the building was first placed in service or (2) the date of any prior rehabilitation for which a credit was allowed under section 48(a)(1)(E).

Another requirement for a qualified rehabilitated building is that the building be rehabilitated. The regulations require that the rehabilitation of the building be substantial. In general, for the rehabilitation to be "substantial," it must either materially extend the useful life of the building, significantly upgrade its usefulness, or preserve it in a manner that significantly improves its condition or enhances its historic value.

Section 48(g) also distinguishes between expenditures for new construction and for rehabilitation. Any expenditures attributable to an enlargement of an existing building are considered to be expenditures for new construction and, therefore, do not qualify for the credit. The final regulations contain rules defining an enlargement of a building and provide allocation rules for cases where expenditures are attributable to both a rehabilitation and an enlargement.

Another requirement for a qualified rehabilitated building is that at least 75 percent of the existing external walls of the building must be retained in place as external walls in the rehabilitation process.

Section 48(g)(1)(C), prior to its amendment by the Economic Recovery Tax Act of 1981, provided that where there is a separate rehabilitation of a major portion of a building, the major portion may be treated as a separate building for purposes of the definition of a qualified rehabilitated building and the twenty-year requirement. These regulations provide that a major portion must consist of clearly identifiable parts of a building and lists factors that are taken into account in determining whether a part of a building is a major portion.

Rehabilitation activity that is done in phases may be considered a single rehabilitation. The final regulations provide rules for determining whether noncontinuous rehabilitation activity constitutes a single rehabilitation done in phases.

Under the version of section 48(g)(2) in effect prior to the amendments made by the Economic Recovery Tax Act of 1981, and the final regulations, the term "qualified rehabilitation expenditure" means any amount properly chargeable to capital account, incurred after October 31, 1978, for property (or additions or improvements to property) with a useful life of five years or more, made in connection with the rehabilitation of a qualified rehabilitated building. The regulations have been revised to make clear that only expenditures for depreciable property qualify as qualified rehabilitation expenditures. The final regulations contain special rules for treating a transferee of a building as having incurred the qualified rehabilitation expenditures of a transferor if the building is acquired before the property attributable to such expenditures is placed in service. In addition, expenditures for property that is "section 38 property" (determined without regard to section 48(a)(1)(E) and (1)), the cost of acquiring an interest in a building, and the costs for an enlargement of a building are not qualified rehabilitation expenditures. Finally, expenditures to rehabilitate a certified historic structure (as defined in section 191(d)(1) and the regulations thereunder) are not qualified rehabilitation expenditures unless the rehabilitation is a certified rehabilitation (as defined in section §1.48-11(c)(8)).

PUBLIC COMMENTS AND CHANGES IN RESPONSE TO COMMENTS

ENLARGEMENTS

Several commenters suggested the regulations should provide some leeway for enlargements that are *de minimus*. However, the statute clearly provides that expenditures for enlargements do not qualify. Also, since only the expenditures attributable to the enlargement of the building are excluded from the definition of qualified rehabilitation expenditure (*i.e.*, the entire rehabilitation is not necessarily disqualified), there is no need for a *de minimus* rule. Therefore, no change was made in the final regulations.

EXTERNAL WALL

A number of commenters requested that the rule defining an "external wall" be clarified. The proposed regulations contained the rule that a common wall was not an external wall. After careful consideration, the regulations are clarified to provide that an abutting wall (*i.e.*, a wall that abuts the wall of a separate building) and a shared wall (*i.e.*, a single wall serving two buildings) are external walls. An alternative rule, however, provides that if a taxpayer is adversely affected by the treatment of party walls in these final regulations, the taxpayer may continue to use the old definition of external wall.

MAJOR PORTION TEST

In response to comments regarding the major portion provision, the "facts and circumstances" test in the proposed regulations is revised to include as a factor whether the portion rehabilitated constitutes a separate leasehold interest.

PHASED REHABILITATIONS

A rule in the proposed regulations required that a written set of architectural plans and specifications describing the rehabilitation be in existence at the commencement of the project for a rehabilitation done in phases to qualify as a single rehabilitation. The final regulations provide that written plans generally describing all phases of the rehabilitation of the building are sufficient even though such plans are not architectural plans and specifications.

TIMING OF THE CREDIT

The proposed regulations provided that the credit could be claimed only in the taxable year in which the property is placed in service. In response to comments, the final regulations make it clear that qualified progress expenditure treatment is available under section 46(d) if the requirements of that section are met.

DRAFTING INFORMATION

The principal author of these regulations is John G. Schmalz of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service participated in developing these

regulations, both on matters of substance and style.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this final rule is not a major legislative rule as defined in Executive Order 12291. Because the notice of proposed rulemaking for this final rule was published prior to January 1, 1981 (the effective date for the Regulatory Flexibility Act), this final rule is not subject to the provisions of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*)

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Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph 1. These regulations are issued under the authority of 26 U.S.C. 7805, and the authority citation for Part 1 remains unchanged.

Par. 2. Section 1.46-4(d) is amended by adding a new paragraph (d)(5) to read as follows:

§1.46-4 Limitations with respect to certain persons.

* * * * *

(d) *Noncorporate lessors.* * * *

(5) The requirements of this paragraph shall not apply with respect to any property which is treated as section 38 property by reason of section 48(a)(1)(E).

Par. 3. Section 1.48-1 is amended by revising the second sentence of paragraph (a), by revising the first sentence of paragraph (e)(1), and by adding a new sentence immediately after such first sentence of paragraph (e)(1), to read as follows:

§1.48-1 Definition of section 38 property.

(a) *In general.* * * * Except as otherwise provided in this section, the term "section 38 property" means property (1) with respect to which depreciation (or amortization in lieu of depreciation) is allowable to the taxpayer, (2) which has an estimated useful life of 3 years or more (determined as of the time such property is placed in service), and (3) which is (i) tangible personal property, (ii) other tangible property (not including a building and its structural components) but only if such other property is used as an integral part of manufacturing, production, or extraction, or as an integral part of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services by a person engaged in a trade or business of furnishing any such service, or is a research or storage facility used in connection with any of the foregoing activities, (iii) an elevator or escalator which satisfies the conditions of section 48(a)(1)(C), or (iv) in the case of a qualified rehabilitated building, that portion of the basis which is attributable to qualified rehabilitation expenditures. * * *

* * * * *

(e) *Definition of building and structural components.* (1) Generally, buildings and structural components thereof do not qualify as section 38 property. See, however, section 48(a)(1)(E) and (g), and §1.48-11 (relating to investment credit for qualified rehabilitated building). * * *

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Par. 4. Section 1.48-2 is amended by adding a new paragraph (d) to read as follows:

§1.48-2 New section 38 property.

* * * * *

(d) *Special rule for qualified rehabilitated buildings.* Notwithstanding the rules in paragraphs (a) through (c) of this section, that portion of the basis of a qualified rehabilitated building attributable to qualified rehabilitation expenditures is treated as new section 38 property. See section 48(a)(1)(E) and (g), and §1.48-11.

Par. 5. There is inserted immediately after § 1.48-10 the following new §1.48-11:

§1.48-11 Qualified rehabilitated building; expenditures incurred before January 1, 1982.

(a) *In general.* Under section 48(a)(1)(E), that portion of the basis of a qualified rehabilitated building which is attributable to qualified rehabilitation expenditures qualifies as section 38 property. In general, property which is treated as section 38 property by reason of section 48(a)(1)(E) is treated as new section 38 property and therefore is not subject to the used property limitation. See §1.48-2(d). Section 48(g)(1) and paragraph (b) of this section define the term "qualified rehabilitated building". Section 48(g)(2) and paragraph (c) of this section define the term "qualified rehabilitation expenditure". Paragraph (d) of this section provides guidance for coordination of these provisions with other sections of the Code.

(b) *Definition of qualified rehabilitated building*—(1) *In general.* The term "qualified rehabilitated building" means any building and its structural components—

(i) Which has been rehabilitated (within the meaning of paragraph (b)(3) of this section),

(ii) Which was placed in service (within the meaning of §1.46-3(d)) by any person at any time before the beginning of the rehabilitation,

(iii) 75 percent or more of the existing external walls of which are retained in place as external walls (within the meaning of paragraph (b)(4) of this section) in the rehabilitation process, and

(iv) Which meets the twenty-year requirement in paragraph (b)(2) of this section.

In addition, a major portion of a building may be treated as a separate building for purposes of this paragraph if the requirements of paragraph (b)(5) of this section are met.

(2) *Twenty-year requirement*—(i) *In general.* A building is considered a qualified rehabilitated building only if a period of at least 20 years has elapsed between the date physical work on the rehabilitation of the building began, and the later of—

(A) The date the building was first placed in service (see §1.46-3(d)) by any person as a building, or

(B) The date the building was placed in service by any taxpayer in connection with a prior rehabilitation with respect to which a credit was allowed by reason of section 48(a)(1)(E).

(ii) *Vacant periods.* The 20-year period include periods during which a building was vacant or devoted to a personal use and is computed without regard to the number of owners or the identity of owners during the period.

(iii) *Physical work on a rehabilitation.* For purposes of this section, "physical work on a rehabilitation" be-

gins when actual construction begins. The term "physical work on a rehabilitation" does not include preliminary activities such as planning, designing, securing financing, exploring, researching, developing plans and specifications, or stabilizing a building to prevent deterioration (*e.g.*, placing boards over broken windows).

(iv) *Special rule.* If a part of a building meets the twenty-years requirement in subdivision (i) of this subparagraph and a part (for example, an addition) does not, a rehabilitation of that part that meets the requirement may qualify for a credit only if that part constitutes a major portion (as defined in paragraph (b)(5) of this section) of the building.

(3) *Rehabilitation*—(i) *In general.* For purposes of this paragraph, rehabilitation includes renovation, restoration, or reconstruction. However, the term "rehabilitation" does not include enlargement (within the meaning of paragraph (c)(7)(ii) of this section), new construction, or the completion of new construction after a building has been placed in service. For purposes of this paragraph (b)(3), whether expenditures are attributable to the rehabilitation of an existing building, or to new construction, is determined upon all the facts and circumstances.

(ii) *Substantial rehabilitation.* For a building to be considered rehabilitated, the rehabilitation must be substantial. Whether a rehabilitation is substantial is determined upon the basis of all the facts and circumstances. In general, to be substantial, the rehabilitation must do one of the following:

(A) materially extend the useful life of the building;

(B) significantly upgrade its usefulness (for either the same or a new use); or

(C) preserve it in a way that significantly improves its condition or enhances its historic value.

A substantial rehabilitation may vary in degree from gutting and extensive reconstruction of a building's major structural components to the cure of a substantial accumulation of major disrepairs. It may also include renovation, alteration, or remodelling for the conversion of a structurally sound building to a design and condition required for a new use. Cosmetic improvements alone, however, do not qualify as a substantial rehabilitation.

(iii) *Aggregation of rehabilitation.* In the case where qualified rehabilitation expenditures are incurred with respect to a rehabilitation of a building by more than one person (*e.g.*, a lessor and a lessee, several lessees, or several condominium owners), the substantial rehabilitation requirement in this paragraph (b)(3) shall be applied by aggregating all the rehabilitation work done by such persons.

(iv) *Special rule for qualified rehabilitation expenditures treated as incurred by the taxpayer.* In the case where qualified rehabilitation expenditures are treated as having been incurred by a taxpayer. In the case where qualified rehabilitation expenditures are treated as having been incurred by a taxpayer because of the application of paragraph (c)(3)(ii) of this section, the substantial rehabilitation test in paragraph (b)(3)(ii) of this section will be applied by aggregating the rehabilitation work done by the transferor and the transferee.

(v) *Examples.* The provisions of this subparagraph (3) may be illustrated by the following examples:

Example (1). Taxpayer A is the owner of a 30-year old building. The building is air conditioned by means of window air conditioning units. A replaces the window units with a central air conditioning system and no other rehabilitation is performed by A. The expenditures incurred by A did not materially extend the building's useful life, significantly upgrade its usefulness, or preserve it in a manner that significantly improves its condition or enhances its historic value. Although expenditures for replacement of window units with a central air conditioning system may constitute qualified expenditures as part of an overall rehabilitation, alone they do not qualify as a substantial rehabilitation and the building is not considered rehabilitated within the meaning of this subparagraph.

Example (2). Taxpayer B is the owner of a 10 story office building that is 35 years old. The building is in substantial disrepair and in order to modernize it as an office building B installs new plumbing, electrical wiring, and heating and air conditioning systems. In addition, the layout of each floor is changed by means of tearing down many existing interior walls and partitions and building new walls, partitions, and doors. Old plaster is removed from many walls and replaced by new wall covering. New windows and new flooring are installed throughout the building. The improvements made by B materially extend the useful life of the building and significantly upgrade its usefulness. The building is considered rehabilitated within the meaning of the facts and circumstances test in this subparagraph.

Example (3). Taxpayer C is the owner of a 100-year old building that has substantial historic character, although the building is not a certified historic structure (as defined in section 191(d)(1) and the regulations thereunder). C uncovers and restores the original woodwork, wall coverings and molding throughout the building. The windows and doors are replaced with replicas of the original. The improvements made by C significantly preserve the building and significantly enhance its historic value. Thus, the building is considered rehabilitated within the meaning of this subparagraph.

(4) *Retention of 75 percent of external walls*—(i) *In general.* A building meets the requirements set forth in paragraph (b)(1)(iii) only if 75 percent or more of the existing external walls (as measured by the total area of the existing external walls) are retained in place as external walls in the rehabilitation process. For this purpose, the area of existing external walls includes the area of windows and doors.

(ii) *External wall.* For purposes of this paragraph (b)(4), a wall includes both the supporting elements of the wall and the nonsupporting elements (*e.g.*, a curtain) of the wall. Except as otherwise provided in this paragraph (b)(4), the term "external wall" includes any wall that has one face exposed to the weather, earth, or an abutting wall erected on an adjacent property. An external wall also includes a shared wall (*i.e.*, a single wall shared with an adjacent building), generally referred to as a "party wall".

(iii) *Alternative rule.* Notwithstanding the definition of external wall contained in paragraph (b)(4)(ii) of this section, in any case in which the building being rehabilitated would fail to meet the requirements of a qualified rehabilitation building if the definition of external wall in paragraph (b)(4)(ii) of this section were used, then the term "external wall" shall be defined as a wall, in including its supporting elements, with one face exposed to the weather or earth, and a common wall shall not be treated as an external wall.

(iv) *Retained in place.* An existing external wall is retained in place if the supporting elements of the wall are retained in place. An existing external wall is not retained in place if the supporting elements of the wall are replaced by new supporting elements. An external wall is retained in place, however, if the supporting elements are reinforced in the rehabilitation, provided

that such supporting elements of the external wall are retained in place. An external wall is retained in place even though it is covered (e.g., with new siding). Moreover, the existing curtain may be replaced with a new curtain provided that the structural framework that provides for the support of the existing curtain is retained in place. An external wall is retained in place notwithstanding that the existing doors and windows in the wall are modified, eliminated, or replaced. A wall may be disassembled and reassembled so long as the same supporting elements are used when the wall is reassembled. Thus, for example, in the case of the brick wall, the wall is considered retained in place even though the original bricks are removed (for cleaning, *etc.*) and put back to form the wall.

(v) *Retention as an external wall.* For purposes of meeting the 75 percent requirement of this subparagraph (4), an existing external wall must be retained in place as an external wall. If an addition is made that results in an existing external wall being converted into an internal wall, the wall is not retained in place as an external wall.

(vi) *Special rule.* Solely for the purpose of meeting the 75 percent requirement of this subparagraph (4), the walls of an uncovered internal shaft designed solely to bring light or air into the center of a building which are completely surrounded by external walls of the building and which enclose space not designated for occupancy or other use by people (other than for maintenance or emergency) are not considered external walls. Thus, a wall of a light well in the center of an office building is not an external wall. However, walls surrounding an uncovered courtyard which is usable by the building's occupants, (*e.g.*, at lunch time) are external walls.

(vii) *Examples.* The provisions of this subparagraph (4) may be illustrated by the following examples:

Example (1). Taxpayer A rehabilitated a building all of the walls of which consisted of wood siding attached to gypsum board sheets (which covered the studs). A covered the existing wood siding with aluminum siding in a part of a rehabilitation that otherwise qualified under this subparagraph. A satisfied the requirement that 75 percent of the existing external walls must be retained in place as external walls.

Example (2). Taxpayer B rehabilitated a building the external walls of which had a masonry curtain. The masonry on the wall face was replaced with a glass curtain. The steel beam and girders supporting the existing curtain were retained in place. B satisfied the requirement that 75 percent of the existing external walls must be retained in place as external walls.

Example (3). Taxpayer C rehabilitated a building which has two external walls measuring 75′ × 20′ and two other external walls measuring 100′ × 20′. C tore down one of the larger walls, including its supporting elements, which accounted for more than 25% of the building's external walls and constructed a new wall. C has not satisfied the requirement that 75 percent of the existing external walls must be retained in place as external walls.

Example (4). The facts are the same as in example 3, except C does not tear down any walls, but makes an addition that results in one of the smaller walls becoming an internal wall. In addition, C enlarged 8 of the existing windows on the larger walls, increasing them from a size of 3′ × 4′ to 6′ × 8′. Since the smaller wall accounts for less than 25 percent of the total wall area, C has satisfied the requirement that 75 percent of the existing external walls must be retained in place as external walls in the rehabilitation process. The enlargement of the existing windows on the larger wall does not change the result.

(5) *Major portion treated as separate building*—(i) *In general.* Where there is a separate rehabilitation of a major portion of a building, such major portion shall be treated as a separate building. Thus, such major portion may qualify as a qualified rehabilitated building if the requirements of this paragraph are met with respect to such major portion. Expenditures for property that services both a major portion of a building and another portion must be specifically allocated to each portion to the extent possible. If it is not possible to make such an allocation, the expenditures must be allocated to each portion on some reasonable basis. What constitutes a reasonable basis for an allocation depends on factors such as the type of improvement and how the improvement relates functionally to the building. For example, in the case of expenditures for an airconditioning system or a roof, a reasonable basis for allocating the expenditures would be the volume of the major portion served by the improvement relative to the volume of the other portion of the building served by the improvement.

(ii) *Major portion defined.* Whether a part of a building constitutes a major portion of the building is determined upon the basis of all the facts and circumstances. A major portion must generally consist of clearly identifiable parts of a building (*e.g.*, a wing of a building or the first 5 stories of a 7 story building). The following factors shall be taken into account:

(A) Whether the portion comprises an entire leasehold interest or an entire ownership (*e.g.*, condominium) interest;

(B) Whether the portion (as measured by volume) is sufficiently large that it would be reasonable to treat it as a separate building; and

(C) Whether the portion is functionally different from other parts of the building.

(6) *Special rule for rehabilitation done in phases.* If rehabilitation which is not continuous is determined under this subparagraph to be a single rehabilitation done in phases, the requirements of this paragraph (b) are to be applied with respect to the overall rehabilitation and not merely to a phase of the rehabilitation. In such case, a phase of a single overall rehabilitation will not be considered as "prior rehabilitation" for purposes of subparagraph (2)(i)(B) of this paragraph (b). Whether rehabilitation which is not continuous is a single rehabilitation that is done in phases is determined on the basis of all the facts and circumstances. Generally, however, to constitute a single rehabilitation that is done in phases, there must exist, prior to the time any rehabilitation work is commenced, a set of written plans describing generally all phases of the rehabilitation of the building and a reasonable expectation that all phases of the rehabilitation will be completed. Such written plans are not required to contained detailed working drawings or detailed specifications of the material to be used. In addition, the period between the time that physical work on the first phase of the overall rehabilitation begins and physical work on the last phase of the overall rehabilitation begins must be reasonable. In determining whether the rehabilitation is completed within a reasonable time, the fact that a building is occupied during the rehabilitation, the necessity of acquiring a lease (of additional portions of the building), and unforeseen delays shall be taken into account. Other factors that are relevant in determining whether rehabilitation is a single rehabilitation include the length of time between each phase of rehabilitation activities and the extent of rehabilitation

activity in each phase.

(7) *Special rule for adjoining buildings that are combined.* For purposes of this paragraph (b), if as part of a rehabilitation process two or more adjoining buildings are combined and placed in service as a single building after the rehabilitation process, then all of the requirements of a qualified rehabilitated building in section 48(g)(1) and this section may be applied to the constituent adjoining buildings in the aggregate. Any party walls or abutting walls between the constituent buildings that would otherwise be treated as external walls (within the meaning of paragraph (b)(4)(ii) of this section) would not be treated as external walls of the building; the substantial rehabilitation test in paragraph (b)(3)(ii) of this section would be applied to the aggregate rehabilitation work with respect to all of the constituent buildings.

(c) *Definition of qualified rehabilitation expenditures*—(1) *In general.* Except as provided in subparagraph (2) of this paragraph, the term "qualified rehabilitation expenditure" means any amount—

(i) Property chargeable to capital account (as described in subparagraph (2) of this paragraph),

(ii) Incurred after October 31, 1978, for depreciable or amortizable property (or additions or improvements to property) with a useful life of five years or more, and

(iii) Made in connection with the rehabilitation of qualified rehabilitated building.

(2) *Chargeable to capital account.* For purposes of paragraph (c)(1)(i) of this section, amounts paid or incurred are chargeable to capital account if under the taxpayer's method of accounting they are properly includible in computing basis under §1.46-3. Amounts treated as an expense and deducted in the year they are paid or incurred are not chargeable to capital account.

(3) *Incurred by the taxpayer*—(i) *In general.* Generally, to qualify for a credit under section 48(a)(1)(E), qualified, rehabilitation expenditures must be incurred by the taxpayer after October 31, 1978. An expenditure is incurred for purposes of this paragraph on the date such expenditure would be considered incurred under the accrual method of accounting, regardless of the method of accounting used by the taxpayer with respect to other items of income and expense. If qualified rehabilitation expenditures are treated as having been incurred by a taxpayer under paragraph (c)(3)(ii) of this section, the taxpayer shall be treated as having incurred the expenditures on the date such expenditures were incurred by the transferor.

(ii) *Qualified rehabilitation expenditures treated as incurred by the taxpayer.* (A) Where rehabilitation expenditures are incurred with respect to a building by a person (or persons) other than the taxpayer and the taxpayer acquires the building, or a portion of the building to which the expenditures are allocable, the taxpayer acquiring such property will be treated as having incurred the rehabilitation expenditures actually incurred by the transferor (or treated as incurred by the transferor under this paragraph (c)(3)(ii)) with respect to the acquired property, provided that—

(1) the building, or the portion of the building, acquired by the taxpayer was not used after the rehabilitation expenditures were incurred and prior to the date of acquisition by the taxpayer, and

(2) No credit with respect to such qualified rehabilitation expenditures is claimed by anyone other than the taxpayer acquiring the property.

For purposes of this paragraph (c)(3)(ii), use shall mean actual use, whether personal or business.

(B) The amount of qualified rehabilitation expenditures treated as incurred by the taxpayer under this paragraph is the lesser of—

(1) The qualified rehabilitation expenditures incurred before the date on which the taxpayer acquired the building (or portion thereof), to which the expenditures are attributable, or

(2) That portion of the taxpayer's cost or other basis for the property which is attributable to the qualified rehabilitation expenditures described in paragraph (c)(3)(B)*(1)* of this section incurred before such date.

For purposes of paragraph (c)(6)(ii) of this section, the amount of rehabilitation expenditures treated as incurred by the taxpayer under this paragraph (c)(3)(ii) shall not be considered to be part of the cost of acquiring a building or any interest in the building. The portion of the cost of acquiring a building (or an interest therein) which is not treated under this paragraph as qualified rehabilitation expenditures incurred by the taxpayer is not eligible for a rehabilitation investment credit. See paragraph (c)(6)(ii) of this section.

(C) See paragraph (b)(2)(iv) of this section for rules concerning the application of the substantial rehabilitation test to expenditures treated as incurred by the taxpayer.

(iii) *Examples.* The provisions of this subparagraph may be illustrated by the following examples:

Example (1). In 1978, taxpayer A, a cash basis taxpayer, commenced the rehabilitation of a 30-year old building. In June 1978, A signed a contract with a plumbing contractor for replacement of the plumbing in the building. A agreed to pay the contractor as soon as the work was completed. The work was completed in September 1978, but A did not pay the amount due until November 1, 1978. The expenditures for the plumbing are not qualified rehabilitation expenditures because they were not incurred after October 31, 1978.

Example (2). B incurred qualified rehabilitation expenditures of $300,000 with respect to an existing building between January 1, 1980, and May 15, 1980, and then sold the building to C on June 1, 1980. If the property attributable to the expenditures was not placed in service by A during the period from January 1, 1980, to June 1, 1980, C will be treated as having incurred the expenditures.

(4) *Incurred for 5-year property.* An expenditure is incurred for depreciable or amortizable property if the amount of the expenditure is added to the basis of property which is depreciable or amortizable under section 167. The determination of whether property has a useful life of five years or more is made by applying the principles of §1.46-3(e). In the case of expenditures for property made by a lessee, see sections 167 and 178 and the regulations thereunder for rules relating to whether improvements made to leased property are depreciable or amortizable.

(5) *Made in connection with the rehabilitation of a qualified rehabilitated building.* Expenditures attributable to work done to facilities related to a building (*e.g.*, sidewalk, parking lot, landscaping) are not considered made in connection with a rehabilitation of a qualified rehabilitated building.

(6) *Certain expenditures excluded from qualified rehabilitation expenditures.* The term "qualified rehabilitation

expenditures" does not include the following expenditures:

(i) An expenditure for property which is "section 38 property" (determined without regard to section 48(a)(1)(E) and (l)).

(ii) The cost of acquiring a building or any interest in a building (including a leasehold interest) except as provided in paragraph (c)(3)(ii) of this section.

(iii) An expenditure attributable to enlargement of a building (as defined in paragraph (c)(7) of this section).

(iv) An expenditure attributable to rehabilitation of a certified historic structure (as defined in section 191(d)(1) and the regulations thereunder), unless the rehabilitation is a certified rehabilitation (as defined in paragraph (c)(8) of this section).

(7) *Expenditures for enlargement distinguished*—(i) *In general.* Expenditures attributable to an enlargement of an existing building do not qualify as qualified rehabilitated expenditures. A building is enlarged to the extent that the total volume of the building is increased. An increase in floor space resulting from interior remodelling is not considered an enlargement. Generally, the total volume of a building is equal to the product of the floor area of the base of the building and the height from the underside of the lowest floor (including the basement) to the average height of the finished roof (as it exists or existed). For this purpose, floor area is measured from the exterior faces of external walls (other than shared walls that are external walls) and from the centerline of shared walls that are external walls. In addition, a building is enlarged to the extent of any construction outside the exterior faces of the existing external wall of the building.

(ii) *Rehabilitation which includes enlargement.* If expenditures for property only partially qualify as qualified rehabilitation expenditures because some of the expenditures are also attributable to the enlargement of the building, the expenditures must be apportioned between the original portion of the building and the enlargement. This allocation should be made using the principles contained in paragraph (b)(5)(i) of this section.

(8) *Certified rehabilitation*—(i) *In general.* For the purpose of this paragraph (c) of this section, the term "certified rehabilitation" means any rehabilitation of a certified historic building in a registered historic district which the Secretary of the Interior has certified to the Secretary as being consistent with the historic character of such building or the district in which such building is located.

(ii) *Revoked or invalidated certifications.* If the Department of Interior revokes or otherwise invalidates a certification after it has been provided to a taxpayer, the decertified property will cease to be section 38 property described in section 48(a)(1)(E). Such cessation shall be effective as of the date the activity giving rise to the revocation or invalidation occurred. See section 47 for the rules applicable to property that ceases to be section 38 property.

(d) *Coordination with other provisions of the Code*—(1) *Credit by lessees*—(i) *Rehabilitation performed by lessor.* A lessee may take the credit for rehabilitation performed by the lessor if the requirements of this section and section 48(d) are satisfied. For purposes of applying section 48(d), the fair market value of section 38 property described in section 48(a)(1)(E) shall be equal to that portion of the lessor's basis in a qualified rehabilitated building that is attributable to qualified rehabilitation expenditures.

(ii) *Rehabilitation performed by lessee.* A lessee may take the credit for rehabilitation performed by the lessee, provided that the property (or improvements or additions to property) for which the rehabilitation expenditures are made is depreciable (or amortizable) by the lessee (see sections 167 and 178, and the regulations thereunder) and the requirements of this section are satisfied.

(2) *When credit may be claimed.* The investment credit for qualified rehabilitation expenditures is allowed generally in the taxable year in which the property to which the rehabilitation expenditures is attributable is placed in service, provided the building is a qualified rehabilitated building for the taxable year. See §1.46-3(d). Under certain circumstances, however, the credit may be available prior to the date the property is placed in service. See section 46(d) and §1.46-5 (relating to qualified progress expenditures).

(3) *Recapture.* If property described in section 48(a)(1)(E) is disposed of by the taxpayer, or otherwise ceases to be "section 38 property," recapture may result under section 47. Property will cease to be section 38 property, and therefore recapture may occur under section 47, in any case where the Department of Interior revokes or otherwise invalidates a certification of rehabilitation (see section 48(g)(2)(C)) after the property is placed in service because, for example, the taxpayer made modifications to the building inconsistent with Department of Interior standards.

(e) *Effective date*—(1) *General rule.* Except as provided in paragraph (e)(2) of this section, this §1.48-11 shall not apply to expenditures incurred after December 31, 1981.

(2) *Transitional rule.* This §1.48-11 shall continue to apply to expenditures incurred after December 31, 1981, for the rehabilitation of a building if—

(i) The physical work on the rehabilitation began before January 1, 1982, and

(ii) The building does not meet the requirements of section 48(g)(1) of the Code as amended by the Economic Recovery Tax Act of 1981.

(This Treasury decision is issued under the authority contained in sections 48(g) and 7805 of the Internal Revenue Code of 1954 (92 Stat. 2828, 26 U.S.C. 48(g), 68A Stat. 917, 26 U.S.C. 7805).)

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved June 18, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 27, 1985, 8:45 a.m., and published in the issue of the Federal Register for June 28, 1985, 50 F.R. 26696)

Subpart F.—Rules for Computing Targeted Jobs Credit

Section 51.—Amount of Credit

26 CFR 1.51-1: Amount of credit.
(Also Section 381; 1.381(c)(26)-1.)

T.D. 8062

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 5—TEMPORARY INCOME TAX REGULATIONS UNDER THE REVENUE ACT OF 1978; PART 5h— TEMPORARY REGULATIONS— ELECTIONS UNDER VARIOUS PUBLIC LAWS, SUBCHAPTER H, PART 602—REPORTING AND RECORDKEEPING REQUIREMENTS

Credit for the Employment of Certain New Employees

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under sections 51 and 381 of the Internal Revenue Code of 1954, relating to a credit for the employment of certain new employees (the "targeted jobs credit"). The amount of the targeted jobs credit that an employer is entitled to is determined under section 51 and these final regulations. These final regulations also provide rules concerning the extent to which an acquiring corporation must take into account items that relate to the targeted jobs credit determined under section 51 in the case of a transaction subject to section 381(a). Changes to the applicable law were made by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1], the Technical Corrections Act of 1979 [Pub. L. 96-222, 1980-1 C.B. 499], the Economic Recovery Tax Act of 1981, [Pub. L. 97-34, 1981-2 C.B. 256], the Tax Equity and Fiscal Responsibility Act of 1982, [Pub. L. 97-248, 1982-2 C.B. 462] the Technical Corrections Act of 1982 [Pub. L. 97-448, 1983-1 C.B. 451], and the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. These final regulations provide the public with the guidance needed to comply with the law as amended by these Acts.

DATES: The amendments are generally effective for certain wages paid or incurred after December 31, 1978, to an individual who begins work for the employer before January 1, 1986.

FOR FURTHER INFORMATION CONTACT: John G. Schmalz of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224. Attention: CC:LR:T (202-566-3516, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

Proposed amendments to the Income Tax Regulations (26 CFR Part 1) were published in the FEDERAL REGISTER on November 23, 1983 [LR-218-81, 1984-1 C.B. 705]. Those amendments were proposed to conform the regulations to section 321 of the Revenue Act of 1978 (92 Stat. 2830) [Pub. L. 95-600, 1978-3 C.B. (Vol. 1), 1, 64], section 103(a)(6) of the Technical Corrections Act of 1979 (94 Stat. 209) [Pub. L. 96-222, 1980-1 C.B. 499, 507] section 261 of the Economic Recovery Tax Act of 1981 (95 Stat. 260) [Pub. L. 97-34, 1981-2 C.B. 256, 303], section 233 of the Tax Equity and Fiscal Responsibility Act of 1982 (96 Stat. 501) [Pub. L. 97-248, 1982-2 C.B. 462, 510], and section 102 (l) of the Technical Corrections Act of 1982 (96 Stat. 2374) [Pub. L. 97-448, 1983-1 C.B. 451, 456].

Approximately 20 written comments were received in response to the notice of proposed rulemaking. A public hearing was held on February 29, 1984. After consideration of all the public comments, the proposed amendments are adopted as revised by this Treasury decision.

In addition, these final regulations also reflect amendments made to section 51 of the Internal Revenue Code by sections 474(p), 712(n), 1041, 2638(b), and 2663(j)(5)(A) of the Tax Reform Act of 1984 (98 Stat. 837, 955, 1042, 1144, and 1171) [Pub. L. 98-369, 1984-3 C.B. (Vol. 1)1, 345, 463, 550, 652, 679].

IN GENERAL

In general, a taxpayer may claim a targeted jobs credit for amounts paid or incurred after December 31, 1978, for taxable years ending after that date, to members of a targeted group. Generally, to qualify for the credit, the amounts must be paid or incurred to members of a targeted group first hired after September 26, 1978. However, amounts paid or incurred after December 31, 1978, to a vocational rehabilitation referral hired before September 27, 1978, may qualify for the credit if a credit under section 44B (as in effect prior to enactment of the Revenue Act of 1978) was claimed for the individual by the taxpayer for a taxable year beginning before January 1, 1979.

AMOUNT OF CREDIT

Except in the case of a qualified summer youth employee, the amount of the targeted jobs credit for the taxable year is 50 percent of the qualified first-year wages plus 25 percent of the qualified second-year wages. Generally, qualified first-year wages are the first $6,000 of wages paid or incurred by the employer during the taxable year to an individual who is a member of a targeted group for services rendered during the 1-year period beginning with the day the individual begins work for the employer. Qualified second-year wages are the first $6,000 of wages paid or incurred by the employer during the taxable year to an individual who is a member of a targeted group for services rendered during the 1-year period beginning on the day after the last day of the qualified first-year wages period. For taxable years of the employer beginning before January 1, 1982, qualified first-year wages are further limited to 30 percent of the aggregate unemployment insurance wages paid by the employer during the calendar year ending in such taxable year.

Special rules apply to wages that are paid to employees who are qualified summer youth employees. In general, an employer is entitled to a credit equal to 85 percent of not more than $3,000 of wages paid to a qualified summer youth employee during a 90-day period between May 1 and September 15.

MEMBERS OF A TARGETED GROUP

An indiviudal is a member of a targeted group if the individual is certified as a qualified summer youth employee, a vocational rehabilitation referral, an economically disadvantaged youth, an economically disadvantaged Vietnam-era veteran, an SSI receipient, a general assistance recipient, a youth participating in a cooperative education program, an economically disadvantaged ex-convict, an eligible work in-

centive employee, or an involuntarily terminated CETA employee. The first category was added by the Tax Equity and Fiscal Responsibility Act of 1982. The last two categories were added by the Economic Recovery Tax Act of 1981. The Economic Recovery Tax Act also amended the definition of a youth participating in a cooperative education program to require the individual to be also a member of an economically disadvantaged family.

The regulations provide rules and definitions relating to the eligibility requirements for several of the targeted groups. In the case of youths participating in a cooperative education program, the regulations define the term "program of vocational education" (a component in the definition of qualified cooperative education program) in accordance with the definition of that term in the Vocational Education Act of 1963 and the Department of Education regulations thereunder because the legislative history of the Revenue Act of 1978 indicates that the term "qualified cooperative education program" in section 51(d)(8) is similar to that term as used in the Vocational Education Act.

The regulations also provide guidance on the issue of second certifications with respect to employees who continue to work for the same employer after the employee no longer meets the requirements for membership in the targeted group for which the employee was originally certified. For example, a qualified summer youth employee may continue to work for the same employer after the end of the ninety-day period described in section 51(d)(12)(B)(iii) and may then qualify as an economically disadvantaged youth. Similarly, a youth certified as participating in a qualified cooperative education program may no longer be actively participating in the program, but may then qualify as an economically disadvantaged youth. The regulations provide that the timely certification rules do not apply to the second certification if the first certification was timely. The regulations also provide that, for purposes of the eligibility requirements, the "hiring date" will be defined as the day the individual is certified for the second targeted group. Thus, whether an individual meets the age requirement for the second targeted group will be determined as of the date of certification rather than the original hiring date.

In general, the State employment security agency is the agency responsible for certifying an individual as a member of a targeted group. In the case of youths participating in a qualified cooperative education program, the school offering the program must certify the individual as a member of that targeted group. A school may satisfy the certification requirement by using Form 6199. In either case, a certificate may be revoked if it is discovered that the information supplied by the individual for purposes of issuing the certificate was incorrect or false.

Furthermore, the amendments made by the Economic Recovery Tax Act have the effect of making retroactive certifications invalid unless the employer has requested in writing a certification before the employee began work. Therefore, an individual will not be treated as a member of a targeted group unless, before the day the individual begins work for the employer, the employer receives a certification from the designated local agency or school, or has requested in writing a certification. However, the Tax Equity and Fiscal Responsibility Act of 1982 amended this rule with respect to individuals who begin work for the employer after May 11, 1982, so that certifications will be valid if requested or received on or before the day the individual begins work for the employer. Transitional rules apply with respect to certain employees. In addition, the Tax Reform Act of 1984 amended the timely certification rules to extend the deadline for requesting a certification to 5 days after the individual begins work for the employer if the individual has received a "voucher" (*i.e.*, a preliminary determination of targeted group eligibility) on or before the day the individual begins work for the employer.

PUBLIC COMMENTS AND CHANGES MADE IN RESPONSE TO PUBLIC COMMENTS

Several commentators objected to two aspects of the proposed regulations relating to the targeted group "youths participating in qualified cooperative education programs." First, they objected to the rule in §1.51-1(c)(2)(iii) of the proposed regulations which provided that the requirement in section 51(d)(8)(B) that both the education and the work experience contribute to the student's education and employability is not met unless the employment is related to the occupation for which the student is in training. The Treasury Department has carefully considered the public comment on this issue, but continues to believe that the proposed rule is correct. Therefore, no substantive change is made.

Commentators also objected to the conclusion in example (9) of the proposed regulations that a student who worked for an employer during the summer vacation did not meet the "activity pursuing" requirement in section 51(d)(8)(A)(iii) during the summer since the cooperative education program that the student was enrolled in did not continue during the summer. The final regulations clarify that this is the case only if the qualified cooperative education program of the school is not continued by the school during the summer vacation. Whether the program continues during the summer is determined by reference to the written agreement between the employer and the school. If the school does continue the program throughout the summer, the student will be considered to be actively pursuing the program regardless of whether the student attends classes during the summer.

GENERAL ASSISTANCE RECIPIENT

The regulations also clarify, in response to public comment, that in order to be considered a general assistance recipient (within the meaning of section 51(d)(6)) it is not necessary that the individual be the individual to whom the assistance check is issued. It is sufficient that the individual be a member of the same assistance unit (within the meaning of 45 CFR 205.40 (a)(1)) as the person receiving the assistance.

Several other comments in the nature of legislative suggestions were made by certain commentators. Although considered, changes were not made since these comments did not pertain to the regulations.

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

The Commissioner of Internal Reve-

nue has determined that this final rule is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required. The Internal Revenue Service has concluded that the final regulations herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

PAPERWORK REDUCTION ACT

The collection of information contained in these final regulations has been submitted to the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these final regulations is John G. Schmalz of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1, Part 5, Part 5h, and Part 602 are amended as follows:

INCOME TAX REGULATIONS
(26 CFR Part 1)

Paragraph 1. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805. * * * Section 1.51-1(g) also issued under 26 U.S.C. 51(j); §1.381(c)(26)-1 also issued under 26 U.S.C. 381(c)(26).

Par. 2. There is inserted immediately after §1.50B-1 the following new §1.51-1 to read as follows:

§1.51-1 Amount of credit.

(a) *Determination of amount*—(1) *General rule.* Except as provided in paragraph (a)(2) of this section, the amount of the targeted jobs credit for purposes of section 38 (formerly designated section 44B) for the taxable year equals 50 percent of the qualified first-year wages (minus any qualified first-year wages paid to individuals while such individuals are qualified summer youth employees) plus 25 percent of the qualified second-year wages.

(2) *Special rule for employment of qualified summer youth employees.* In the case of an employer who pays or incurs qualified wages after April 30, 1983, to a qualified summer youth employee beginning work for the employer after such date, the amount of the targeted jobs credit for the taxable year is equal to the amount determined under paragraph (a)(1) of this section plus an amount equal to 85 percent of the first $3,000 of qualified wages paid to each qualified summer youth employee during the taxable year. Such wages must be attributable to services rendered by the qualified summer youth employee during an 90-day period beginning on or after May 1 and ending on or before September 15.

(3) *Limitation.* See section 38(c) for rules limiting the amount of the credit to a percentage of the amount of the taxpayer's net tax liability.

(b) *Definitions*—(1) *Qualified wages.* The term "qualified wages" means wages (as defined in paragraph (b)(4)) paid or incurred by the employer during the taxable year to individuals who are members of a targeted group (within the meaning of section 51(d)).

(2) *Qualified first-year wages*—(i) *General rule.* Except in the case of qualified summer youth employees, the term "'qualified first-year wages" means the first $6,000 of wages (as defined in paragraph (b)(4) of this section) attributable to service rendered by a member of a targeted group during the 1-year period beginning with the day the individual first begins work for the employer. In the case of a vocational rehabilitation referral (as defined in section 51(d)(2)) who begins work for the employer before July 19, 1984, the one-year period begins with the day the individual begins work for the employer on or after the beginning of such individual's rehabilitation plan. However, with the exception of vocational rehabilitation referrals for whom the employer claimed a credit under section 44B (as in effect prior to enactment of the Revenue Act of 1978) for a taxable year beginning before January 1, 1979, members of a targeted group who are first hired after September 26, 1978, and before January 1, 1979, will be treated as if they first began work for the employer on January 1, 1979. The date on which the wages are paid is not determinative of whether the wages are first-year wages; rather, the wages must be attributed to the period during which the work was performed. See paragraph (f)(1) of this section for an additional limitation on the term "qualified first-year wages". (See examples (1), (2), (3), (4), (5), and (6) in paragraph (j) of this section for examples illustrating the application of the rules in this paragraph (b)(2)).

(ii) *Special rule for qualified summer youth employees.* In the case of a qualified summer youth employee, qualified first-year wages for purposes of the 85 percent credit referred to in paragraph (a)(2) of this section include only wages attributable to services rendered by a qualified summer youth employee during any 90-day period beginning on or after May 1 and ending on or before September 15. If the individual is retained by the employer after the 90-day period and recertified as a member of another targeted group, the term "qualified first-year wages" for purposes of the 50 percent credit described by section 51(a)(1) has the meaning assigned that term in paragraph (b)(2)(i) of this section except that the $6,000 limitation for qualified first-year wages shall be reduced by wages up to, but not more than, $3,000 attributable to services rendered during the 90-day period.

(3) *Qualified second-year wages.* The term "qualified second-year wages" means the first $6,000 of wages attributable to services rendered by a member of a targeted group, other than a qualified summer youth employee, during the 1-year period beginning on the day after the last day of the period for qualified first-year wages. The date on which the wages are paid is not determinative of whether the wages are second-year wages; rather, the wages must be attributed to the period during which the work was performed.

(4) *Wages*—(i) *General rule.* Except as otherwise provided in paragraph (b)(4)(ii) and (iii) of this section, the

term "wages" shall only include amounts paid or incurred after December 31, 1978, for taxable years ending after December 31, 1978. For purposes of this section, the term "wages" has the meaning assigned such term by section 3306(b) (determined without regard to any dollar limitation contained in such subsection).

(ii) *Special rules.* In the case of agricultural labor or railway labor, the term "wages" means unemployment insurance wages within the meaning of subparagraph (A) or (B) of section 51(h)(1). The term "wages" shall not include any amounts paid or incurred by an employer for any pay period to any individual for whom the employer receives federally funded payments for on-the-job training for such individual for such pay period. (See example (7) in paragraph (j) of this section.) The amount of wages which would otherwise be qualified wages under this section with respect to an individual for a taxable year shall be reduced by an amount equal to the amount of payments made to the employer (however ultilized by such employer) with respect to such individual for such taxable year under a program established under section 414 of the Social Security Act. In addition, the term "wages" shall not include any amount paid or incurred by the employer in a taxable year beginning before January 1, 1982, to an individual with respect to whom the employer claims a credit under Section 40 (relating to expenses of work incentive programs). For youths participating in a qualified cooperative education program:

(A) Section 3306(c)(10)(C) (relating to the definition of employment for certain students) does not apply in determining wages under this section; and

(B) The term "wages" shall include only those amounts paid or incurred by the employer that are attributable to services rendered by the individual while he or she meets the conditions specified in section 51(d)(8)(A). For purposes of the preceding sentence, an employee who met the requirement in section 51(d)(8)(A)(iv), dealing with economically disadvantaged status, when hired, shall be deemed to continuously meet the requirement in section 51(d)(8)(A)(iv) during the time the employee is in the cooperative education program. See also paragraph (e) of this section for rules relating to the exclusion of wages paid to certain individuals.

(iii) *Termination.* The term "wages" shall not include any amount paid or incurred to an individual who begins work for the employer after December 31, 1985.

(5) *Special rule for eligible work incentive employees.* In the case of an eligible work incentive employee (as defined in §1.51-1(c)(4)), this paragraph (b) shall be applied for taxable years beginning after December 31, 1981, as if such employee had been a member of a targeted group for taxable years beginning before January 1, 1982. (See example (8) in paragraph (j) of this section.)

(c) *Members of targeted groups*—(1) *In general.* An individual is a member of a targeted group if the individual is certified as (i) a vocational rehabilitation referral, (ii) an economically disadvantaged youth, (iii) an economically disadvantaged Vietnam-era veteran, (iv) an SSI recipient, (v) a general assistance recipient, (vi) a youth participating in a cooperative education program, (vii) an economically disadvantaged ex-convict, (viii) an eligible work incentive employee, (ix) a qualified summer youth employee, or (x) an involuntarily terminated CETA employee. Except as provided below, see section 51(d) of this section for a definition of these groups. See paragraph (d) of this section for rules concerning the certification of individuals as members of one of these targeted groups.

(2) *Youths participating in a qualified cooperative education program*—(i) *Student requirements.* For an individual to qualify as a youth participating in a qualified cooperative education program, the individual must meet each of the following conditions (A) through (D)—

(A) The youth must have attained the age of 16 but not 20. (An individual reaching 19 will be treated as a youth participating in a qualified cooperative education program only for wages paid or incurred after November 26, 1979.)

(B) The youth must not have graduated from a high school or vocational school.

(C) The youth must be enrolled in and actively pursuing a qualified cooperative education program (as defined in paragraph (c)(2)(iii) of this section).

(D) With respect to wages paid or incurred after December 31, 1981, the youth must be a member of an economically disadvantaged family when initially hired.

(ii) *Economically disadvantaged family.* See section 51(d)(11) for the rules relating to the determination of whether an individual is a member of an economically disadvantaged family.

(iii) *Qualified cooperative education program.* The term "qualified cooperative education program" means a program of vocational education for individuals who (through written cooperative arrangements between a qualified school and one or more employers) receive instruction (including required academic instruction) by alternation of study in school with a job in any occupational field (but only if these two experiences are planned by the school and employer so that each contributes to the student's education and employability). See section 51(d)(8)(C) for the definition of a "qualified school." For purposes of this paragraph, the term "program of vocational education" means an organized educational program which is directly related to the preparation of individuals for employment, or for additional preparation for a career requiring other than a baccalaureate or advanced degree. An "organized educational program" means only instruction related to the occupation or occupations for which the students are in training or instruction necessary for students to benefit from such training. The student's employment contributes to his or her education and employability only if it is related to the occupation, or a cluster of closely related occupations, for which the student is in training in school. However, the student's employment need not be directly related to or in the same technical field as the training the student receives in school. For example, a student studying carpentry does not have to work as a carpenter for the program to constitute a "qualified cooperative education program." The program will qualify if, for example, the student works at a hardware store because the student's work would familiarize the student with the materials and tools used by carpenters. The program

would not qualify, however, if the student works at a restaurant and generally performs tasks in such employment not related to carpentry.

(iv) *Actively pursuing.* For purposes of this paragraph (c)(2), a youth will not be considered to be "actively pursuing" a school's qualified cooperative education program (within the meaning of paragraph (c)(2)(iii) of this section) during summer vacation unless that school program continues during the summer vacation. Whether the school program continues during the summer vacation will be determined by examining the written agreement between the school and the employer. Thus, if a written agreement specifically covers the summer vacation period and provides for a significant degree of involvement by school personnel to provide supervision for the students in the program during that period, the school program will be considered to continue during the summer, regardless of whether classes are held during the vacation period.

(3) *General assistance recipients.* In order for an individual to qualify as a general assistance recipient, the individual, or another member of the assistance unit (within the meaning 45 CFR 205.40(a)(1)) that the individual is a member of, must receive assistance for a period of not less than 30 days ending within the preemployment period (as defined in section 51(d)(13)) from a qualified general assistance program. A qualified general assistance program is a program of a State or a political subdivision of a State that the Secretary (after consultation with the Secretary of Health and Human Services) has designated as providing general assistance (or similar assistance) which is based on need and consists of money payments or voucher or scrip. For purposes of the preceding sentences, a program qualifying as a general assistance program by reason of non-cash assistance (*i.e.*, voucher or script) shall be so treated only with respect to amounts paid or incurred after July 1, 1982, to individuals beginning work for the employer after such date. For purposes of this subparagraph, the term "money" means cash or an instrument convertible into cash (*e.g.*, a check).

(4) *Eligible work incentive employees.* An eligible work incentive employee means an individual who has been certified by the designated local agency (as defined in paragraph (d)(10) of this section) as—

(i) Being eligible for financial assistance under part A of title IV of the Social Security Act and as having continuously received such financial assistance during the 90-day period which immediately precedes the date on which such individual is hired by the employer, or

(ii) Having been placed in employment under a work incentive program established under section 432(b)(1) or 445 of the Social Security Act.

The provisions of this paragraph (c)(4) are effective with respect to taxable years of the employer beginning after December 31, 1981. (See paragraph (b)(5) of this section for a special rule relating to eligible work incentive employees.)

(5) *Involuntarily terminated CETA employees*—(i) *In general.* An involuntarily terminated CETA employee is an individual who first began work for an employer after August 13, 1981, in taxable years of the employer ending after August 13, 1981, and is certified by the designated local agency (as defined in paragraph (d)(10) of this section) as having been involuntarily terminated after December 31, 1980, from employement financed in whole, or in part, under a program under part D of title II or title VI of the comprehensive Employment and Training Act.

(ii) *Termination.* Section 51(d)(10) and this paragraph (c)(5) shall not apply to any individual who begins work for the employer after December 31, 1982.

(d) *Certification*—(1) *General rule.* Except as otherwise provided in this paragraph, an individual shall not be treated as a member of a targeted group unless, on or before the day on which such individual begins work for the employer, the employer has received, or has requested in writing, a certification that the individual is a member of a targeted group from the designated local agency (as defined in paragraph (d)(10) of this section). In addition, the employer must receive a certification before the targeted jobs credit can be claimed. However, with respect to individuals who began work for the employer on or before May 11, 1982, the certification will be timely only if requested or received before the day the individual began work for the employer. In the case of a request in writing mailed via the United States Postal Service, the request shall be deemed to be made on the date of the postmark stamped on the cover in which such request was mailed to the designated local agency provided the request is mailed in accordance with the mailing requirements in §301.7502-1(c) and delivered in accordance with the delivery requirements in §301.7502-1(d). In the case of a deadline that but for this sentence would fall on a Saturday, Sunday, or a legal holiday, the deadline for making a timely request in writing for a certification or receiving a timely certification shall be the next succeeding day which is not a Saturday, Sunday, or legal holiday. (See section 7503 for the definition of "legal holiday.") See paragraph (d)(2) of this section for transitional rules applicable to certain employees who began work for the employer before September 26, 1981. See paragraph (d)(3) of this section for special rules applicable to cooperative education students and paragraph (d)(4) of this section for special rules applicable to eligible work incentive employees.

(2) *Timeliness of certification in the case of an individual to whom a written preliminary eligibility determination has been issued.* If on or before the day on which an individual begins work for the employer, such individual has received from a designated local agency (or other agency or organization designated pursuant to a written agreement with such designated local agency) a written preliminary determination that such individual is a member of a targeted group, then such individual may be treated as a member of a targeted group if on or before the fifth day after the day such individual begins work for the employer such employer receives, or requests in writing, from the designated local agency a certification that such individual is a member of a targeted group. This paragraph (d)(2) only applies to individuals who begin work for the employer after July 18, 1984.

(3) *Transitional rules for certain employees who began work for the employer on or before September 26, 1981.* In the case of an individual, other than a cooperative education stu-

dent, who began work for the employer before June 29, 1981, the employer must either receive, or request in writing, a certification before July 23, 1981. In the case of an individual, other than a cooperative education student, who began work for the employer after June 28, 1981, and on or before September 26, 1981, the employer must either receive, or request in writing, a certification before September 26, 1981.

(4) *Cooperative education students.* In the case of cooperative education students, the school administering the cooperative education program must issue the certification. Form 6199 is provided for this purpose. If the student begins work for the employer after September 26, 1981, see the general rule in §1.51-1(d)(1) for the date when this certification must be received or requested. If the student begins work for the employer on or before September 26, 1981, the employer must receive the certification or request it in writing before September 26, 1981. In order for an employer to claim a credit on wages paid or incurred to a cooperative education student after December 31, 1981, the employer must receive or request in writing a determination that the student is a member of an economically disadvantaged family. A request for economic eligibility determination for a cooperative education student must be made in writing by the employer to the participating school. If the student begins work for the employer on or before September 26, 1981, the employer must receive or request in writing such determination before September 26, 1981. However, a request in writing on or after August 13, 1981, to a participating school for certification will be deemed to include a request for an economic eligibility determination. In addition, any certification issued by a school after August 13, 1981, will be deemed to be issued in response to a request for certification which includes a request for an economic eligibility determination. The rule in the preceding sentence does not eliminate the requirement that the employer receive a certification that includes an economic eligibility determination in order to claim a credit for wages paid or incurred after December 31, 1981. If a certification issued by a school after August 13, 1981, does not contain an economic eligibility determination and the employer wishes to claim a credit for wages paid or incurred after December 31, 1981, the employer must receive a completed certification before the date on which the credit is claimed.

(5) *Eligible work incentive employees.* In the case of eligible work incentive employees, the employer must either receive, or request in writing, a certification within the time requirements of paragraph (d)(1), (2), or (3) of this section, whichever is applicable. Before October 12, 1981 (the date the Economic Recovery Tax Act of 1981 codified the State employment security agency as the designated local agency for certifying targeted groups), a certificate may be received or requested in writing from either the designated local agency (as defined in paragraph (d)(10) of this section) or the office or agency that properly issued certifications under former section 50B(h)(1) (relating to the work incentive credit.)

(6) *Certifications that are not timely.* Any certification that is not timely received or requested by the employer in accordance with the rules of this paragraph will be treated as invalid. Thus, the employer will not be allowed to claim a credit under section 51 with respect to any wages paid or incurred to an employee whose certification or request for certification is not timely. A timely request for certification does not eliminate the need for the employer to receive a certification before claiming the credit. In the case of a request for certification that was denied, resubmitted, and then approved, the timeliness of the request shall be determined by the timeliness of the first request.

(7) *Incorrect certification*—(i) *In general.* Except as otherwise provided in paragraph (d)(7)(ii) of this section, if an individuual has been certified as a member of a targeted group, and such certification is based on false information provided by such individual, the certification shall be revoked and wages paid by the employer after the date on which notice of revocation is received by the employer shall not be treated as qualified wages. For purposes of this paragraph, a certification will be revoked only if the individual would not have been certified had correct information been provided to the issuer of the certification. Thus, false information that is not material to an individual's eligibility as a member of a targeted group will not invalidate an otherwise valid certification.

(ii) *Employer's knowledge that the certification was incorrect.* In the case of an employer who knew, or had reason to know, at the time of certification that the information provided to the designated local agency was false, none of the wages paid by such employer to an individual to whom an incorrect certification has been issued will be qualified wages.

(8) *Certifications issued to certain rehires.* This paragraph (d)(8) applies in the case of an employee who first began work for the employer before August 13, 1981, and was dismissed and rehired by the employer. A certification received or requested by an employer with respect to such an employee will be considered timely only if there was a valid business reason, unrelated to the availability of the credit, for the dismissal and rehire and if the employer did not dismiss and then rehire the employee in order to meet the timing requirement with respect to certification. An individual who is dismissed and then rehired for the purpose described in the preceding sentence will be considered for purposes of section 51(d)(16) and this paragraph to have been continuously employed by the employer during the time between the dismissal and the rehire. Whether the employer was motivated by reason of the certification rules in section 51(d)(16) and this paragraph to dismiss and then rehire an employee is a question of fact to be determined from all the circumstances surrounding the dismissal and rehire. (See paragraph (e)(2) of this section for a separate rule disallowing the credit in the case of nonqualifying rehires.)

(9) *Individuals who continue to be employed by the same employer but as a member of another targeted group.* This paragraph (d)(9) applies in the case of an employee who continues to be employed by the same employer but no longer qualifies as a member of the targeted group for which such employee was first certified (*e.g.*, the employee was originally certified as a qualified summer youth employee with

respect to a ninety-day period between May 1 and September 15, but such ninety-day period has ended). In such case, the employer may request a certification that the employee is a member of another targeted group, and if any wages paid to such individual are qualified first-year wages or qualified second-year wages, the employer may be entitled to a targeted jobs credit with respect to such wages. The second certification will not be invalid merely because it was requested or received after the individual began work for the employer; only the first certification (for example, the certification with respect toan individual hired first as a qualified summer youth employee) must meet the requirement of section 51(d)(16) that a certification must be requested or received by an employer on or before the day on which the individual begins work for the employer. In the case of a former qualified summer youth employee or a youth participating in a qualified cooperative education program who is recertified as an economically disadvantaged youth, the term "hiring date" in section 51(d)(3)(B) does not mean the day the individual is hired by the employer but means the day the individual is certified as a member of the new targeted group. Accordingly, the age requirement of section 51(d)(3)(B) shall be applied as of the day the individual is certified as a member of the second targeted group. In addition, see section 51(d)(11) for rules concerning the viability of the original economic eligibility determination.

(10) *Certification where a trade or business has been transferred to a new employer.* In the case of a transfer of a trade or business in which an individual who is a member of a targeted group is retained as an employee in the trade or business, the certification obtained for such employee by the transferor-employer will apply with respect to the transferee-employer.

(11) *Designated local agency*—(i) *In general.* For the period before October 12, 1981, the term "designated local agency" means the agency for any locality designated jointly by the Secretary and the Secretary of labor to perform certifications of employees for employers in that locality. On or after October 12, 1981, the term "designated local agency" means a State employment security agency established in accordance with the Act of June 6, 1933, as amended (29 U.S.C. 49-49n).

(ii) *Jurisdiction.* The designated local agency is the agency that has, pursuant to its charter, jurisdiction over the individual that is sought to be certified. Thus, any certification that is issued with respect to an individual who is not within the jurisdiction of the designated local agency that issued the certification will be invalid. Notwithstanding any other provision of this section, a request in writing for certification to be appropriate designated local agency that is made before January 23, 1984, will be considered to be timely if it is made after an otherwise timely request in writing for certification was made to a designated local agency that does not have jurisdiction over the individual sought to be certified.

(e) *Certain ineligible individuals*—(1) *Related individuals.* For purposes of section 51(a), "qualified wages" does not include any amounts paid or incurred by a taxpayer to any of the following individuals:

(i) An individual who is related (within the meaning of any of paragraphs (1) through (8) of section 152(a)) to the taxpayer;

(ii) An individual who is a dependent (within the meaning of section 152(a)(9)) of the taxpayer;

(iii) An individual who is related (within the meaning of any of paragraphs (1) through (8) of section 152 (a)) to a shareholder who owns (within the meaning of section 267(c)) more than 50 percent in value of the outstanding stock of the taxpayer, if the taxpayer is a corporation;

(iv) An individual who is a dependent (within the meaning of section 152(a)(9)) of a shareholder described in paragraph (e)(1)(iii) of this section;

(v) An individual who is a grantor, beneficiary or fiduciary of the taxpayer, if the taxpayer is an estate or trust;

(vi) An individual who is a dependent (within the meaning of section 152(a)(9)) of an individual described in paragraph (e)(1)(v) of this section; or

(vii) An individual who is related (within the meaning of any of paragraphs (1) through (8) of section 152(a)) to an individual described in paragraph (e)(1)(v) of this section.

(2) *Nonqualifying rehires.* For pur poses of section 51(a), "qualifie wages" does not include wages paid t an employee who had been employe by the employer prior to the curren hiring date of the employee if at an time during such prior employment th employee was not a member of a tar geted group. The preceding sentenc shall not apply to an employee wh was previously timely certified as member of a targeted group with re spect to the same employer. An em ployee shall be treated as not having been a member of a targeted group i the certification requirements of section 51(d)(16) were not met. (See example (8) in paragraph (j) of this section.)

(3) *Effective date.* The provisions of this paragraph (e) are effective with respect to employees first beginning work for an employer after August 13, 1981.

(f) *Limitations*—(1) *Limitation on qualified first-year wages.* With respect to taxable years beginning before January 1, 1982, the amount of the qualified first-year wages which may be taken into account for purposes of the targeted jobs credit for any taxable year shall not exceed 30 percent of the aggregate unemployment insurance wages paid by the employer during the calendar year ending in such taxable year. In the case of a group of trades or businesses under common control (as defined in §1.52-1(b)), the qualified first-year wages cannot exceed 30 percent of the aggregate unemployment insurance wages paid to all employees of that group of trades or businesses under common control during the calendar year ending in such taxable year. For this purpose, the term "unemployment insurance wages" has the same meaning given to the term "wages" as defined in §1.51-1(b)(4). In this case of agricultural or railway labor, see section 51(h)(1) for the applicable definition of unemployment insurance wages. (See examples (13) and (14) in paragraph (j) of this section.)

(2) *Remuneration must be for trade or business employment.* Remuneration paid by an employer to an employee during any taxable year shall be taken into account only if more than one-half of the remuneration paid by the employer to an employee is for services in a trade or business of the employer. This determination shall be made by

each employer without regard to section 52(a) or (b). Accordingly, employees of corporations that are members of a controlled group or employees of partnerships, proprietorships, and other trades or businesses (whether or not incorporated) which are under common control will be treated as being employed by each separate employer for this purpose. For this purpose, the term "year" means the taxable year of the employer. (See example (15) in paragraph (j) of this section.)

(g) *Election not to claim the targeted jobs credit.* The election under section 51(j) (as amended by section 474(p) of the Tax Reform Act of 1984) not to claim the targeted jobs credit is available for taxable years beginning after December 31, 1983, and shall be made for the taxable year in which such credit is available by not claiming such credit on an original return or amended return at any time before the expiration of the 3-year period beginning on the last date prescribed by law for filing the return for the taxable year (determined without regard to extensions). The election may be revoked within the 3-year period by filing an amended return on which the credit is claimed.

(h) *Treatment of successor-employers.* In the case of a successor-employer referred to in section 3306(b)(1), the determination of the amount of credit under this section with respect to wages paid by such successor-employer shall be made in the same manner as if such wages were paid by the predecessor-employer referred to in such section. Thus, the 1-year period referred to in §1.51-1(b)(2)(i) will be considered to begin with the day the employee first began work for the transferor-employer, and the amount of qualified first-year wages and qualified second-year wages paid or incurred with respect to the employee must be reduced by the amount of any such wages paid or incurred by the transferor-employer. (See examples (10) and (11) in paragraph (j) of this section.) Also, see paragraph (d)(10) of this section for rules concerning the viability of the employee's certification.

(i) *Treatment of employees performing services for other persons.* No credit shall be determined under this section with respect to remuneration paid by an employer to an employee for services performed by such employee for another person unless the amount reasonably expected to be received by the employer for such services from such other person exceeds the remuneration paid by the employer to such employee for such services.

(j) *Examples.* The application of this section may be illustrated by the following examples which, except as otherwise stated, assume that the limitations imposed by §§1.51-1(f)(2) and 1.53-3 are inapplicable:

Example (1). Corporation M is a calendar year, cash receipts and disbursements method taxpayer. A, an economically disadvantaged youth, first began work for Corporation M on October 1, 1978. Qualified first-year wages with respect to A are wages attributable to the period beginning on January 1, 1979 (since A was first hired after September 26, 1978, he is treated as having begun work on January 1, 1979) and ending on December 31, 1979. In the 1979 taxable year, Corporation M pays A $5,000 of qualified first-year wages attributable to services performed in 1979. Corporation M's allowable credit is equal to $2,500 (50 percent of $5,000).

Example (2). Assume the same facts as in example (1), except that in 1980 Corporation M pays to A $100 of wages attributable to services rendered in 1979. These wages will still be considered as qualified first-year wages, but the credit may not be claimed until the 1980 taxable year.

Example (3). Corporation O is a calendar year, cash receipts and disbursements method taxpayer. C, a vocational rehabilitation referral, first began work for Corporation O on July 1, 1978. Corporation O claimed a credit under section 44B (as in effect prior to enactment of the Revenue Act of 1978) for $3,000 of wages paid to C in the 1978 taxable year. Corporation O paid C $6,000 for services performed from January 1, 1979 to June 30, 1979. The period during which qualified first-year wages are determined begins on July 1, 1978, and ends on June 30, 1979. Amounts paid before January 1, 1979, however, are not taken into consideration in determining the amount of qualified first-year wages. Accordingly, only the wages attributable to services performed from January 1, 1979, through June 30, 1979, are considered as qualified first-year wages. Corporation O's allowable credit is equal to $3,000 (50 percent of $6,000).

Example (4). I first began work for Corporation Q, a cash receipts and disbursement method taxpayer, on January 1, 1981, and was not a member of a targeted group. On March 1, 1981, I was convicted of a felony and sentenced to prison. I quit working for Corporation Q, and served the prison sentence. On November 1, 1981, I again was hired by Corporation Q and began work on that date. On the November 1, 1981 hiring date, I was an economically disadvantaged ex-convict for whom Corporation Q received a certificate. Corporation Q paid I $500 of wages for services performed from November 1, 1981, to December 31, 1981, and $6,000 of wages for services performed during 1982. The $500 of wages paid for services performed from November 1, 1981, to December 31, 1981, would be qualified first-year wages because these qualified wages were paid for services performed during the 1-year period beginning on the date I first began work for Corporation Q (January 1, 1981). The $6,000 of wages paid for services performed during 1982 would be qualified second-year wages because these qualified wages were paid for services performed during the 1-year period beginning on the day after the first 1-year period. Accordingly, Corporation Q has an allowable credit of $250 attributable to qualified first-year wages and $1,500 attributable to qualified second-year wages.

Example (5). Assume the same facts as in example (4), except that all dates are 1 year later. Thus, I first began work for Corporation Q on January 1, 1982, was convicted on March 1, 1982, and was rehired on November 1, 1982. Under these facts, Q is not entitled to take a targeted jobs credit with respect to I's wages because I is a nonqualifying rehire.

Example (6). J, an economically disadvantaged youth, first began work for Corporation R, a calendar year cash receipts and disbursements method taxpayer, on December 1, 1979. On July 1, 1980, J was laid off by Corporation R and began work for Corporation S, which is unrelated to Corporation R, on July 2, 1980. On November 1, 1980, J again began work for Corporation R and continued working for Corporation R until January 1, 1982. At the time J first began work for Corporation S, J no longer met the qualifications of an economically disadvantaged youth. Corporation S may not claim a credit for wages paid to J because J was not a member of a targeted group at the time he began work for Corporation S. Corporation R, however, may claim a credit for wages paid to J because J was a member of a targeted group when he was hired by Corporation R. Corporation R's qualified first-year wages paid to J are the wages paid for services performed by J from December 1, 1979, to July 1, 1980, and from November 1, 1980, to November 30, 1980. Corporation R's qualified second-year wages paid to J are wages paid for services performed by J from December 1, 1980, to November 30, 1981. Corporation R may not claim a credit for wages paid for services performed by J after November 30, 1981.

Example (7). K, a member of a targeted group, first began work for Corporation T on January 1, 1979. For the pay periods from January 1, 1979, to March 31,1979, Corporation T received federally funded payments for on-the-job training for K and paid wages of $2,000 to K. During the remainder of 1979 Corporation T paid wages of $7,000 to K. Corporation T may claim a credit on $6,000 of qualified first-year wages. Amounts paid to K by Corporation T during the pay periods for which Corporation T received federally funded payments for on-the-job training for K are not considered wages for purposes of the credit. However, Corporation T may consider $6,000 of the total $7,000 of wages paid after March 31, 1979, as qualified first-year wages.

Example (8). P first began work for Corporation X on January 1, 1981, as an individual who was certified to be an eligible employee for purposes of the WIN credit provided in section 40. Corporation X paid P $6,000 of wages during its taxable year beginning on January 1, 1981, and

$6,000 of wages during its taxable year beginning on January 1, 1982. X can claim a targeted jobs credit for the wages paid in 1982 if the requirements of section 51 are met. For purposes of section 51(a), P's qualified first-year wages are the wages paid from January 1, 1981, to December 31, 1981, and P's qualified second-year wages are the wages paid from January 1, 1982, to December 31, 1982. Thus, Corporation X is only entitled to claim a targeted job credit based on P's qualified second-year wages.

Example (9). (i) L, 15 years of age, first began work for Corporation U on August 1, 1979. On September 3, 1979, L began her junior year in high school and enrolled in a qualified cooperative education program that was to run for her junior and senior years. On October 1, 1979, when L turned 16, she met all the requirements of §1.51-1(c)(2)(i) and qualified as a youth participating in a qualified cooperative education program. Corporation U is entitled to claim a credit on wages paid or incurred for services performed by L after September 30, 1979, so long as L meets the requisite requirements. L's summer vacation began on June 1, 1980. Assume that the cooperative education program L was enrolled in did not continue during the summer vacation (*i.e.*, the written agreement between the employer and the school did not cover the summer vacation). Thus, during her summer vacation, L did not meet the requirement of actively pursuing a qualified cooperative education program. Accordingly, Corporation U may not claim a credit on wages paid for services performed by L during L's summer vacation. On September 2, 1980, L began her senior year, and again met all the requirements of §1.51-1(c)(2)(i). She continued to meet these requirements until June 5, 1981, when she graduated from high school. Accordingly, Corporation U may claim a credit on wages paid for services performed after September 1, 1980, and before June 5, 1981.

(ii) Assume the same facts as in (i), above, except that all dates are 3 years later. Under these facts, U is not entitled to claim a targeted jobs credit with respect to any of L's wages because L has not been timely certified under section 51(d)(16) and §1.51-1(d)(3).

Example (10). D began work for a drugstore owned by E as a sole proprietor on January 1, 1979, and was certified as a member of a targeted group with respect to E. On June 1, 1979, E sold the drugstore where D worked to F, who continued to operate the drugstore with D as an employee. D's qualification as a member of a targeted group is not required to be redetermined in order for F to qualify for the targeted jobs credit. F will take into account the certification of D's eligibility that was provided to E. F will have qualified first-year wages consisting of the first $6,000 of wages paid or incurred to D by E and F from January 1, 1979 to December 31, 1979 (reduced by any qualified wages paid or incurred by E to D from January 1, 1979, to May 31, 1979). F's qualified second-year wages will consist of the first $6,000 of wages paid or incurred to D by F from January 1, 1980, to December 31, 1980.

Example (11). G began work in a machine shop owned by H as a sole proprietor on January 1, 1979, and was certified as a member of a targeted group with respect to H. On June 1, 1980, H transferred all the assets of the machine shop to newly formed Corporation P. Corporation P retained G as an employee in the machine shop. G's qualification as a member of a targeted group is not required to be redetermined in order for P to qualify for the targeted jobs credit. H has qualified first-year wages in the amount of the first $6,000 of wages paid or incurred to G by H from January 1, 1979, to December 31, 1979. Corporation P has qualified second-year wages in the amount of the first $6,000 of wages paid or incurred to G by H and Corporation P from January 1, 1980, to December 31, 1980 (reduced by any qualified second-year wages paid by H to G).

Example (12). W operates a retail store as a sole proprietor. On June 1, 1982, W hires S after receiving a written determination from a local community organization that S meets the requirements of an economically disadvantaged youth. W does not request a certification from the State employment security agency as to S's eligibility. W is not entitled to claim a credit with respect to wages paid to S because W did not receive, or request in writing, a certification from the State employment security agency as to S's eligibility on or before the day on which S began work for W.

Example (13). Corporation V is a cash receipts and disbursements method taxpayer with a July 1 through June 30 taxable year. In the taxable year ending June 30, 1980, the aggregate unemployment insurance wages paid by V were $150,000. In calendar year 1979 the aggregate unemployment insurance wages paid by Corporation V were $110,000. Corporation V's qualified first-year wages are limited to 30 percent of the aggregate unemployment insurance wages paid by it in calendar year 1979 or $33,000 (30 percent of $110,000), even though the aggregate unemployment insurance wages paid by it in the taxable year ending June 30, 1980, were $150,000.

Example (14). Assume the same facts as in example (13), except that all dates are 3 years later. Since the limitation on qualified first-year wages does not apply to taxable years beginning after December 31, 1981, Corporation V's qualified first-year wages are $150,000.

Example (15). M operates a retail store as a sole proprietor. N and O, both members of a targeted group, first began work for M on January 1, 1979. M paid N total qualified first-year wages of $6,000 in 1979. Three thousand one hundred dollars of those wages were for services in M's retail store, and $2,900 of those wages were for services as M's maid. M paid O total qualified first-year wages of $6,000 in 1979. Three thousand dollars of those wages were for services in M's store and $3,000 of those wages were for services as M's chauffeur. M has an allowable credit of $3,000 in 1979 on all $6,000 of qualified first-year wages paid to N because more than one-half of the remuneration paid by M to N was for services in M's trade or business. M may not take into account the wages paid to O because not more than one-half of the remuneration paid by M to O was for services in M's trade or business. Accordingly, M may not claim a credit on wages paid to O.

Par. 3. Section 1.381(c)(26)-1 is amended to read as set forth below:

§1.381(c)(26)-1 Credit for employment of certain new employees.

(a) *Carryovers and carrybacks.* For taxable years beginning before January 1, 1984, the computation of carryovers and carrybacks of unused targeted jobs credit (new jobs credit in the case of wages paid before 1979) under section 44B (as in effect prior to enactment of the Tax Reform Act of 1984) in a transaction to which section 381(a) applies shall be made under the principles of §1.381(c)(23)-1 (relating to the computation of carryovers and carrybacks of unused investment credit), except that the provisions of paragraph (c)(4) and paragraph (e)(6), (7) and (8) of such section shall not apply.

(b) *Other items.* See §1.51-1(h) for a rule that applies to certain transfers of a trade or business in which a member of a targeted group is employed.

TEMPORARY REGULATIONS UNDER THE REVENUE ACT OF 1978
(26 CFR Part 5)

Par. 4. The authority for Part 5 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. Section 5.51-1 is removed.

TEMPORARY REGULATIONS—ELECTIONS UNDER VARIOUS PUBLIC LAWS
(26 CFR Part 5h)

Par. 6. The authority for Part 5h continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 7. Section 5h.4(e) is removed.

INTERNAL REVENUE PRACTICE REGULATIONS
(26 CFR Part 602)

Par. 8. The authority citation for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 9. Section 602.101(c) is amended by inserting in the appropriate places in the table "§1.51-1(d). . . 1545-0219."

This Treasury decision includes amendments that conform the regulations to the amendments made to section 51 of the Internal Revenue Code of 1954 by the Tax Reform Act of 1984. Because these are interpretative regulations and because there is need for immediate guidance, the requirement for notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code and the effective date limitation of subsection (d) of

that section are found to be inapplicable with respect to such amendments.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved October 16, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on November 5, 1985, 8:45 a.m., and published in the issue of the Federal Register for November 6, 1985, 50 F.R. 45996)

Subchapter B.—Computation of Taxable Income
Part I.—Definition of Gross Income, Adjusted Gross Income, Taxable Income, etc.

Section 61.—Gross Income Defined

26 CFR 1.61-2: Compensation for services, including fees, commissions, and similar items.

Whether a pension received by a disabled firefighter under a state statute creating a rebuttable presumption the disability was service incurred is includible in gross income. See Rev. Rul. 85-105, page 53.

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26 CFR 1.61-2T: Questions and answers relating to the taxation of fringe benefits (temporary).

The use of employer-provided vehicles for commuting. See T.D. 8061, page 93.

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26 CFR 1.61-7: Interest.

Whether interest on obligations of a political subdivision will be exempt from tax. See Rev. Rul. 85-112, page 33.

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26 CFR 1.61-7: Interest

Whether interest to be paid on obligations of a political subdivision of a state will be exempt from tax. See Rev. Rul. 85-120, page 32.

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26 CFR 1.61-14: Miscellaneous items of gross income.

The amount received by an individual in settlement of a libel suit for injury to personal reputation is includible in the individual's gross income to the extent such amount represents the satisfaction of punitive damages. See Rev. Rul. 85-98, page 51.

Section 62.—Adjusted Gross Income Defined

26 CFR 1.62-1: Deductions from adjusted gross income.

Whether interest and state and local taxes are deductible in addition to the amount of passenger vehicle expenses determined by use of the standard mileage rate. See Rev. Proc. 85-49, page 716.

Section 63.—Taxable Income Defined

26 CFR 1.63-1: Change of treatment with respect to the zero bracket amount and itemized deductions.

Adjusted zero bracket amount set forth for taxable years beginning in 1986. See Rev. Proc. 85-55, page 737.

Part II.—Items Specifically Included in Gross Income

Section 72.—Annuities; Certain Proceeds of Endowment and Life Insurance Contracts

26 CFR 1.72-1: Introduction.

Annuities; withdrawals. The Service explains the Federal income tax consequences, under section 72 of the Code, as amended by the Tax Equity and Fiscal Responsibility Act of 1982, of a cash withdrawal from an annuity contract subsequent to a tax-free exchange of annuity contracts.

Rev. Rul. 85-159

ISSUE

What are the Federal income tax consequences of a withdrawal from an annuity contract after there has been an exchange of annuity contracts qualifying for nonrecognition under section 1035 of the Internal Revenue Code, as described below?

FACTS

The taxpayer, an individual, purchased an annuity contract on March 1, 1973, for 100*x* dollars, with an annuity starting date of June 24, 1993. On September 1, 1982, the taxpayer exchanged the annuity contract for an annuity contract with a different company, with the same annuity starting date. The exchange qualified as a tax-free exchange under section 1035(a) of the Code.

In December 1982, the taxpayer paid an additional premium of 50*x* dollars under the annuity contract. On March 1, 1983, when the contract was not subject to surrender charges, the taxpayer, age 45, made a partial surrender of the annuity and received 160*x* dollars. The cash value of the annuity was 200*x* dollars as a result of: (1) 100*x* dollars in premiums paid prior to August 14, 1982; (2) 50*x* dollars in premiums paid after August 13, 1982; (3) 49*x* dollars in accumulations attributable to investments made prior to August 14, 1982; and (4) 1*x* dollars in accumulations attributable to investments made after August 13, 1982.

LAW AND ANALYSIS

Section 72(e)(2)(B)(i) of the Code requires that amounts received as partial surrenders or cash withdrawals from an annuity contract prior to the annuity starting date be included in gross income to the extent allocable to income on the contract.

Section 72(e)(3)(A) of the Code provides that the amount by which the cash value of the contract (determined without regard to any surrender charge) exceeds the contract owner's investment in the contract immediately prior to receipt is the amount allocable to income on the contract. Distributions of less than the amount by which the cash surrender value exceeds the investment are includible in full in income. Section 72(e)(3)(B) provides that to the extent amounts are not allocable to income under the preceding rule, such amounts shall be allocated to the investment in the contract and, therefore, are not included in gross income. In short, withdrawals are allocated first to income and then to the investment in the contract.

Sections 72(e)(5)(A) and (B) of the Code provide that for contracts entered into before August 14, 1982, the rule contained in section 72(e)(2)(B) treating withdrawals as taxable to the extent allocable to income on the contract does not apply. Instead, amounts received under these contracts before the annuity starting dates are includible in gross income only to the extent they exceed the investment in the contract. Therefore, withdrawals are includible in income only after they exceed the investment in the contract.

Subject to certain exceptions and limitations, section 72(q) of the Code imposes a penalty on premature distributions from annuity contracts. The penalty is 5 percent of the amount includible in the contract owner's gross income. The penalty does not apply to a distribution that is allocable to an investment in the contract made before

August 14, 1982.

H.R. Rep. No. 97-760, 97th Cong., 2d Sess. 647 (1982), 1982-2 C.B. 600, 686 states, referring to the preceding sections: "[A] replacement contract obtained in a tax-free exchange of contracts succeeds to the status of the surrendered contract for purposes of the new provisions."

Thus, pursuant to section 72(e)(5)(B) of the Code, the cash withdrawal rules do not apply to amounts invested in an annuity contract prior to August 14, 1982, nor to income accumulated on such amounts, notwithstanding that the annuity contract was exchanged after August 13, 1982, for another annuity contract in a tax-free exchange under section 1035. Accordingly, under section 72(e)(5)(B) as described above, withdrawals are allocable first to investments prior to August 14, 1982, then to income accumulations with respect to such investments, then, pursuant to section 72(e)(3)(B), to income accumulated with respect to investments after August 13, 1982, and finally to investments after August 13, 1982.

HOLDING

Because the taxpayer received the present annuity in a tax-free exchange, that annuity will retain the attributes of the surrendered annuity for purposes of determining when amounts are to be considered invested and for computing the taxability of any withdrawals.

In the example above, the taxpayer is considered to have withdrawn amounts allocable to the taxpayer's pre-August 14, 1982, investment first. Accordingly, the first 100*x* dollars of the 160*x* dollars withdrawn is treated as a return of capital. The next 49*x* dollars withdrawn is ordinary income since it is allocable to income accumulations on pre-August 14, 1982, investments. The next 1*x* dollars withdrawn is ordinary income allocable to income accumulations on post-August 13, 1982, investments. The remainder of the withdrawal, 10*x* dollars, is attributable to the 50*x* dollars invested after August 13, 1982, and is treated as a return of capital.

The 5 percent penalty only applies to distributions made after December 31, 1982, of income accumulations that are allocable to an investment made after August 13, 1982. Therefore, the penalty tax is 5 percent of 1*x* dollars.

Section 83.—Property Transferred in Connection with Performance of Services

26 CFR 1.83-3: Meaning and use of certain terms.

T.D. 8042

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX: TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Property Transferred in Connection with the Performance of Services

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final Regulations.

SUMMARY: This document contains amendments to the regulations relating to property transferred in connection with the performance of services. These regulations reflect the changes made to the applicable tax law by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256], and revise certain provisions of the existing regulations. The regulations affect taxpayers performing services and taxpayers transferring property in connection with the performance of such services, and provide them with the guidance needed to comply with the law.

DATES: The amendments to §1.83-3(e) apply to property transferred after June 30, 1969. The rules added by paragraphs (j) and (k) of §1.83-3 apply to property transferred after December 31, 1981.

FOR FURTHER INFORMATION CONTACT: Bruce Jurist of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T), 202-566-3238, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On November 16, 1983, the FEDERAL REGISTER published proposed amendments (48 FR 52079) [LR-16-80, 1984-1 C.B. 641] to the Income Tax Regulations (26 CFR Part 1) under section 83 of the Internal Revenue Code. These amendments were proposed to conform the regulations to section 252 of the Economic Recovery Tax Act of 1981 (95 Stat. 260, 26 U.S.C. 83(c)) and make certain corrective and clarifying changes to the existing regulations under section 83. Twelve written comments responding to this notice were received. No requests for a public hearing were received and accordingly none was held. After consideration of all written comments regarding the proposed amendments, all but one of those amendments are adopted as revised by this Treasury decision.

PUBLIC COMMENTS PERIOD OF SECTION 16(b) RESTRICTION

Section 83(c)(3) states that property is nontransferable and subject to a substantial risk of forfeiture so long as the sale of such property at a profit could subject the seller to suit under section 16(b) of the Securities Exchange Act of 1934 ("the 1934 Act"). The proposed regulations under §1.83-3(j) provided that for purposes of section 83 the section 16(b) restriction would be considered to have lapsed after its initial six-month period, notwithstanding any extension of such restriction under the rules of section 16(b) of the 1934 Act. Six comments suggested that for purposes of section 83 the section 16(b) restriction should not lapse after a single six-month period, but rather should continue so long as a suit is maintainable under section 16(b) of the 1934 Act. This suggestion was not adopted because the legislative history of section 83(c)(3) provides that stock subject to the section 16(b) restriction will be treated as being subject to a substantial risk of forfeiture and nontransferable for the six-month period during which that section applies.

Further, five comments were received requesting additional clarification relating to the following issues:

(1) the effect under section 83 of simultaneous restrictions (*i.e.*, performance restrictions in addition to a section 16(b) restriction);

(2) the effect of a section 83(b) election on the section 16(b) restriction;

(3) the effect under section 83 of the

loss of insider status prior to the expiration of the six-month period;

(4) the day on which a section 16(b) restriction period ends (see *Colonial Realty Corp. v. McWilliams*, 381 F. Supp. 26 (S.D.N.Y. 1974)).

(5) the application of section 83 to purchases exempt under rule 16b-3 of the 1934 Act (17 CFR 240.16b-3); and

(6) the effect of a section 16(b) restriction on the determination of the readily ascertainable fair market value of a nonqualified stock option under §1.83-7.

The final regulations respond to issues (1), (2), and (3) (see examples (1) and (2) of §1.83-3(j)(2)) and issue (6) (see the last line in §1.83-3(j)(1)). The final regulations do not provide any additional guidance with respect to issues (4) and (5) because these issues relate primarily to the application of section 16(b) of the 1934 Act and only incidentally to section 83.

EMPLOYER'S DEDUCTION UNDER §1.83-6

The amendments to §1.83-6 as proposed in the November 16, 1983, notice of proposed rulemaking are not adopted by this Treasury decision. Those amendments remain under study by the Service.

SPECIAL ANALYSES

Although a notice of proposed rulemaking soliciting public comments was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these regulations are not subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

The Treasury Department has determined that this final regulation is not a major rule under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983. Accordingly, a Regulatory Impact Analysis is not required.

DRAFTING INFORMATION

The principal authors of these regulations are Bruce H. Jurist and Philip R. Bosco of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, other personnel in the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, after careful consideration of all comments received, 26 CFR Part 1 is amended as follows:

Paragraph 1. These regulations are issued under the authority contained in 26 U.S.C. 7805. The authority citation for Part 1 is unchanged.

Par. 2. Section 1.83—3 is amended by revising paragraph (e) and adding new paragraphs (j) and (k). The amended section reads as follows:

§1.83-3 Meaning and use of certain terms.

* * * * *

(e) *Property.* For purpose of section 83 and the regulations thereunder, the term "property" includes real and personal property other than either money or an unfunded and unsecured promise to pay money or property in the future. The term also includes a beneficial interest in assets (including money) which are transferred or set aside from the claims of creditors of the transferor, for example, in a trust or escrow account. See, however, §1.83-8(a) with respect to employee trusts and annuity plans subject to section 402(b) and section 403(c). In the case of a transfer of a life insurance contract, retirement income contract, endowment contract, or other contract providing life insurance protection, only the cash surrender value of the contract is considered to be property. Where rights in a contract providing life insurance protection are substantially nonvested, see §1.83-1(a)(2) for rules relating to taxation of the cost of life insurance protection.

* * * * *

(j) *Sales which may give rise to suit under section 16(b) of the Securities Exchange Act of 1934*—(1) *In general.* For purposes of section 83 and the regulations thereunder if the sale of property at a profit within six months after the purchase of the property could subject a person to suit under section 16(b) of the Securities Exchange Act of 1934, the person's rights in the property are treated as subject to a substantial risk of forfeiture and as not transferable until the earlier of (i) the expiration of such six-month period, or (ii) the first day on which the sale of such property at a profit will not subject the person to suit under section 16(b) of the Securities Exchange Act of 1934. However, whether an option is "transferable by the optionee" for purposes of §1.83-7(b)(2)(i) is determined without regard to section 83(c)(3) and this paragraph (j).

(2) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). On January 1, 1983, X corporation sells to P, a beneficial owner of 12% of X corporation stock, in connection with P's performance of services, 100 shares of X corporation stock at $10 per share. At the time of the sale the fair market value of the X corporation stock is $100 per share. P, as a beneficial owner of more than 10% of X corporation stock, is liable to suit under section 16(b) of the Securities Exchange Act of 1934 for recovery of any profit from any sale and purchase or purchase and sale of X corporation stock within a six-month period, but no other restrictions apply to the stock. Because the section 16(b) restriction is applicable to P, P's rights in the 100 shares of stock purchased on January 1, 1983, are treated as subject to a substantial risk of forfeiture and as not transferable through June 29, 1983. P chooses not to make an election under section 83(b) and therefore does not include any amount with respect to the stock purchase in gross income as compensation on the date of purchase. On June 30, 1983, the fair market value of X corporation stock is $250 per share. P must include $24,000 (100 share of X corporation stock × $240 ($250 fair market value per share less $10 price paid by P for each share)) in gross income as compensation on June 30, 1983. If, in this example, restrictions other than section 16(b) applid to the stock, such other retrictions (but not section 16(b)) would be taken into account in determining whether the stock is subject to a substantial risk of forfeiture and is nontransferable for periods after June 29, 1983.

Example (2). Assume the same facts as in example (1) except that P is not an insider on or after May 1, 1983, and the section 16(b) restriction does not apply beginning on that date. On May 1, 1983, P must include in gross income as compensation the difference between the fair market value of the stock on that date and the amount paid for the stock.

Example (3). Assume the same facts as in example (1) except that on June 1, 1983, X corporation sells to P an additional 100 shares of X corporation stock at $20 per share. At the time of the sale the fair market value of the X corporation stock is $150 per share. On June 30, 1983, P must include $24,000 in gross income as compensation with respect to the January 1, 1983 purchase. On November 30, 1983, the fair market value of X corporation stock is $200 per share. Accordingly, on that date P must include

$18,000 (100 shares of X corporation stock × $180 ($200 fair market value per share less $20 price paid by P for each share)) in gross income as compensation with respect to the June 1, 1983 purchase.

(3) *Effective date.* this paragraph applies to property transferred after December 31, 1981.

(k) *Special rule for certain accounting rules.* (1) For purposes of section 83 and the regulations thereunder, property is subject to substantial risk of forfeiture and is not transferable so long as the property is subject to a restriction on transfer to comply with the "Pooling-of-Interests Accounting" rules set forth in Accounting Series Release Numbered 130 ((10/5/72) 37 FR 20937; 17 CFR 211.130) and Accounting Series Release Numbered 135 ((1/18/73) 38 FR 1734; 17 CFR 211.135).

(2) *Effective date.* This paragraph applies to property transferred after December 31, 1981.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved July 8, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 5, 1985, 8:45 a.m., and published in the issue of the Federal Register for August 6, 1985, 50 F.R. 31712)

Part III.—Items Specifically Excluded From Gross Income

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-7: Industrial development bonds. (Also Section 61; 1.61-7.)

Industrial development bonds; fish preservation and public recreational facilities; trade or business and security interest tests. Obligations issued by a public utility district in connection with a hydroelectric project to finance construction of a fish bypass system and recreational facilities it is required to build under state and federal law will be industrial development bonds if the underlying facility is subject to an output contract as described in section 1.103-7(b)(5) of the regulations.

Rev. Rul. 85-120

ISSUE:

Will a proposed issue of revenue bonds satisfy the "trade or business test" and the "security interest test" described in section 103(b)(2) of the Internal Revenue Code and section 1.103-7(b)(5) of the Income Tax Regulations, under the circumstances described below?

FACTS:

Q is a public utility district, authorized to acquire, construct and operate structures necessary in the manufacture, distribution, purchase, and sale of electric power. *Q* is also authorized to issue revenue bonds for financing the acquisition, construction, and maintenance of electric utility and related properties.

In 1961, *Q* constructed and placed in service a hydroelectric project consisting of a dam, a reservoir, and electric generating equipment in a powerhouse. In connection with the project, *Q* was required in 1981 under the license issued by the Federal Power Commission to construct and thereafter maintain various facilities for the preservation of fish and for public recreation.

The fish preservation facilities to be installed at the dam site will consist of a fish bypass system designed to protect ocean-migrating fish and to assist them to pass the project safely during their seaward migration.

The recreational facilities above the dam site will consist of camping and picnic areas, swimming pools, boat docks and fishing access areas.

To finance the fish preservation and recreational facilities, *Q* will issue revenue bonds, payable solely out of revenues from the sale of electric energy generated by the hydroelectric project and from user chargers with respect to the proposed recreational facilities.

A privately-owned utility has agreed pursuant to a contract to take or pay for more than 25 percent of the output of the hydroelectric project, as defined in section 1.103-7(b)(5) of the regulations. Pursuant to this contract, the utility is contractually obligated to pay an amount equal to more than 25 percent of the debt service on all of *M*'s revenue bonds issued to finance the construction of the project, including fish passageway and recreational facilities.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on the obligations of a state or its political subdivisions.

Section 103(b)(1) of the Code provides that, except as otherwise provided in section 103(b), any industrial development bond shall be treated as an obligation that is not an obligation described in section 103(a)(1).

Section 103(b)(2) of the Code states that the term "industrial development bond" means any obligation—(A) which is issued as part of an issue all or a major portion of the proceeds of which are to be used directly or indirectly in any trade or business carried on by any person who is not an exempt person, and (B) the payment of the principal or interest on which is, in whole or in major part—(i) secured by any interest in property used or to be used in a trade or business or in payments in respect of such property, or (ii) to be derived from payments in respect of property, or borrowed money, used or to be used in a trade or business.

Section 103(b)(3) of the Code provides that an exempt person is a state or local governmental unit or an organization described in section 501(c)(3).

Section 1.103-7(b)(3)(iii) of the regulations provides, in part, that the use of more than 25 percent of the proceeds of an issue of obligations in trades or businesses of nonexempt persons will be the use of a major portion of such proceeds.

Section 1.103-7(b)(5)(i) of the regulations provides, in part, that the use by one or more nonexempt persons of a major portion of the output of facilities such as electric energy, gas, or water facilities constructed, reconstructed, or acquired with the proceeds of a bond issue satisfies the trade or business test and the security interest test if such use has the effect of transferring to nonexempt persons the benefits of ownership of such facilities, and the burdens of paying the debt service on governmental obligations used directly or indirectly to finance such facilities, so as to constitute the indirect use by them of a major portion of such proceeds.

Section 1.103-7(b)(5)(i) further provides that such benefits and burdens are transferred and a major portion of the proceeds of an issue is used indirectly by the users of the subparagraph (5) output of a facility that is owned and operated by an exempt person where one nonexempt person agrees, pursuant to a contract to take, or to take or pay for, a major portion (more than 25 percent) of the output (within the meaning of subdivision (ii) of this subparagraph) of such a facility (whether or not conditioned upon the production of such output).

In this case, although the fish preservation and recreational facilities will not increase electrical output of the hydroelectric project, they are such facilities which would not be built but for the hydroelectric project. Just as the dam and other facilities for the generation of electricity are properties used in the private utility's trade or business, these facilities that *Q* is required to build and maintain under the license are so closely associated with the hydroelectric project as to be considered a part of the hydroelectric project used in *Q*'s trade or business. Since a nonexempt person as defined in section 103(b)(3) of the Code (a private power purchaser) has agreed to take or pay for more than 25 percent of the output of the hydroelectric project and the payment of more than 25% of the debt service of the bonds will be derived from revenues generated by the output contract, the bonds will satisfy the trade or business test and the security interest test of section 1.103-7(b)(5) of the regulations. Therefore, the bonds will be industrial development bonds within the meaning of section 103(b)(2) of the Code.

HOLDING

The bonds to be issued by *Q* will satisfy the trade or business test and the security interest test of section 1.103-7(b)(5) of the regulations. Therefore, the bonds will be industrial development bonds within the meaning of section 103(b)(2) of the Code.

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26 CFR 1.103-8: Interest on bonds to finance certain exempt facilities.

Industrial development bonds; exempt facility; convention or trade show. Facilities occupying three floors of an eighteen story hotel will not qualify as exempt convention or trade show facilities.

Rev. Rul. 85-94

ISSUE

Will facilities occupying three floors of an eighteen story hotel as described below qualify as exempt convention or trade show facilities within the meaning of section 103(b)(4)(C) of the Internal Revenue Code?

FACTS

As part of a cooperative effort among private investors, local businesses, and the government of *CI* to revitalize convention activity in the city, a developer proposes to acquire and reconstruct a hotel in *CI*. The entire project will cost an estimated $35*x* million dollars. Most of the funds for the project will be from private, taxable obligations. However, as part of the financing plan, the *CI* Industrial Development Authority will issue industrial development bonds in the amount of $8*x* million dollars to finance the construction and restoration of convention and trade show facilities located in the hotel.

The convention and trade show facilities will consist of the first, second and eighteenth floors of the hotel. As restored, the first floor will contain a ballroom as well as nine meeting rooms. The second floor will consist in major part of hospitality suites that will be leased for the display of goods, wares, etc., in connection with convention activities and trade shows. The eighteenth floor will consist of an additional ballroom, a reception room, and five meeting rooms. All of these facilities will be made available for rental to the general public in accordance with a fixed rate schedule.

In addition, the proceeds of the loan will also be used to finance part of the cost of certain public areas and facilities which serve the convention facilities as well as other parts of the hotel.

LAW AND ANALYSIS

Section 103(a) of the Code provides that gross income does not include interest on the obligations of a state or its political subdivisions.

Section 103(b)(1) of the Code provides that, with certain exceptions, industrial development bonds shall not be treated as obligations described in section 103(a).

Section 103(b)(4)(C) of the Code excepts from section 103(b)(1) obligations which are part of an issue substantially all of the proceeds of which are to be used to provide convention or trade show facilities.

Section 1.103-8(d)(2) of the Income Tax Regulations defines the term "convention or trade show facilities" to mean special purpose buildings or structures, such as meeting halls or display areas, which are generally used to house a convention or trade show, including facilities functionally related and subordinate to such facilities such as parking lots or railroad sidings. A hotel or motel which is available to the general public, whether or not it is intended primarily to house persons attending or participating in a convention or trade show is neither a convention or trade show facility nor functionally related and subordinate thereto. Hotel facilities are likewise not within the definition of "convention or trade show facilities". *See*, S. Rep. No. 1014, 90th Cong., 2d Sess. 37 (1968), 1968-2 C.B. 790, 809.

Thus, the exemption for convention and trade show facilities under section 103(b)(4)(C) of the Code applies only to special purpose buildings or structures constructed for housing conventions or trade shows and not to facilities that are an integral part of a hotel. Here, the convention and trade show facilities comprise three floors of an eighteen story hotel and are functionally an integral part of the hotel.

HOLDING

The facilities occupying three floors of an eighteen story hotel will not qualify as exempt convention or trade show facilities within the meaning of section 103(b)(4)(C) of the Code.

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26 CFR 1.103-10: Exemption for certain small issues of industrial development bonds. (Also Section 61; 1.61-7.)

Industrial development bonds; exempt small issue; capital expenditures; capitalized costs. A corporation's proposed costs of purchasing components and assemblying computers in new buildings to be financed with

the proceeds from a city's proposed exempt small issue of industrial development bonds will not be section 103(b)(6)(D) capital expenditures if the computers are leased to users located outside the city.

Rev. Rul. 85-112

ISSUE

Will an "exempt small issue" of industrial development bonds described in section 103(b)(6)(D) of the Internal Revenue Code exceed the exempt small issue limitation of $10,000,000 under the circumstances described below?

FACTS

Corporation *X*, which is not an exempt person within the meaning of section 103(b)(3) of the Code, proposes to construct buildings on land it owns in city *CI* for use as an assembly plant for computers. *X* will purchase the components and other materials, assemble the computers, and lease or sell them to customers for use in their places of business, which are located throughout the United States.

X will capitalize the cost of those computers that it intends to lease. Assembly of each computer will require approximately 2 weeks after necessary materials are received. Assembled computers will then be shipped out of *CI* to branch service centers, lessees, and purchasers. At the time of shipment out of *CI*, the computers will function independently, requiring only an electrical outlet in order to operate. The computers are not specifically designed for any particular lessee's special needs. During the first year of operation, *X* will assemble computers for lease costing approximately $6,000,000. A regional center for long-term storage of surplus computers will be located outside *CI*.

Under the terms of the leases, *X* will be the owner of the leased computers for federal income tax purposes. *X* will lease the computers for terms of more than 3 years. In addition, because *X* will maintain numerous service centers throughout the country, less than 10 percent of *X*'s leased computers will be returned to the plant in *CI* each year for repair, refurbishing, and recycling.

CI purposes to issue registered industrial development bonds described in section 103(b)(2) of the Code in the amount of $8,000,000. The bond proceeds will be loaned to *X* for use in constructing the buildings located in *CI*. Before the issuance of the bonds, *CI* will file a statement electing to treat the bonds as an exempt small issue of $10,000,000 or less under the provisions of section 103(b)(6)(D). *X* has not previously financed any facilities with an exempt small issue. Neither *CI* nor *X* has made or will make any capital expenditures with respect to the facilities during the 3 years before the date of issuance of the bonds.

CI's proposed bond issue will satisfy all the requirements for tax-exemption under section 103 of the Code if the aggregate face amount of such bonds does not exceed the exempt small issue limitation of $10,000,000 under section 103(b)(6)(D)(ii) of the Code.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on the obligations of a state or its political subdivisions.

Section 103(b)(1) of the Code provides that, except as otherwise provided in section 103(b), any industrial development bond will be treated as an obligation that is not decribed in section 103(a)(1).

Section 103(b)(6)(D) of the Code provides that, at the election of the issuer, section 103(b)(1) will not apply to any obligation issued as part of an issue if the aggregate face amount of the issue is $10,000,000 or less and if substantially all (90 percent or more) of the proceeds of the issue are to be used to acquire or construct land or property of a character subject to the allowance for depreciation. To determine the aggregate face amount of a bond issue, the face amount of the bonds to be issued, the outstanding face amount of certain prior exempt small issues, and the aggregate amount of capital expenditures for certain facilities must all be taken into account.

Section 1.103-10(b)(2)(ii) of the Income Tax Regulations provides that an expenditure is a section 103(c)(6)(D) (redesignated as section 103(b)(6)(D)) capital expenditure if:

(a) The capital expenditure was financed other than out of the proceeds of issues taken into account,

(b) The capital expenditures were paid or incurred during the 6-year period that begins 3 years before the date of issuance of the issue and ends 3 years after that date,

(c) The principal user of the facility in connection with which the property resulting from the capital expenditures is used and the principal user of the facility financed by the proceeds of the issue in question is the same person or two or more related persons,

(d) Both facilities referred to in (c) were located in the same incorporated municipality or in the same county (outside the incorporated municipality in the county), and

(e) The capital expenditures were properly chargeable to the capital account of any person or state or local governmental unit (whether or not the person is the principal user of the facility or a related person).

In this case, X will assemble computers during a short period of time (approximately 2 weeks) and transfer the computers outside *CI* for delivery to the lessees. The computers to be returned to X's assembly plant in *CI* by lessees each year for repairs will be insignificant. None of the computers will be stored in *CI* after assembly or repairs.

Because the computers to be assembled for lease will be situated in *CI* for only a temporary period and will not be intended for use in *CI*, such computers will not be considered located in *CI*. They will be considered located in the political subdivisions where they are used by the lessees. Therefore, the capitalized cost of the computers assembled in *CI* for lease will not be considered section 103(b)(6)(D) capital expenditures by *X* in *CI* for purposes of determining the aggregate face amount of the bonds to be issued by *CI*. Such expenditures will not satisfy the requirement under section 1.103-10(b)(2)(ii)(*d*) of the regulations because the facilities (lessees' land and buildings) in connection with which the property resulting from the capital expenditures (computers) will be used and the facility to be financed with the bond proceeds (*X*'s buildings) will not be located in the same incorporated municipality. The cost of the computers will be section 103(b)(6)(D) capital expenditures by *X* in the political subdivi-

sions where the computers are used by the lessees.

HOLDING

The aggregate face amount of the bonds ($8,000,000 face amount) to be issued by *CI* will not exceed the exempt small issue limitation of $10,000,000 under section 103(b)(6)(D) of the Code. Therefore, the interest on the bonds will be excludable from gross income under section 103(a)(1).

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26 CFR 1.103-10: Exemption for certain small issues of industrial development bonds.

Industrial development bonds; exempt small issue; research expenses; capital expenditures. Research expenses will be treated as capital expenditures, within the meaning of section 103(b)(6)(D) of the Code, with respect to the facilities where the product of the research will be used unless such expenses are research expenses described in section 30(b)(2)(A) for which a deduction has been allowed under section 174(a). Rev. Ruls. 77-27 and 77-253 modified and superseded.

Rev. Rul. 85-142

ISSUE

Will expenditures for research and experimental activity be classified as "section 103(b)(6)(D) capital expenditures" in the situations described below for purposes of determining if the exempt small issue limitation of $10,000,000 will be exceeded?

FACTS

Situation 1.

County *CY* proposes to issue industrial development bonds on October 1, 1985, in the amount of $9,500,000 to finance the construction of a factory building in *CY* for use by *X* corporation, a nonexempt person. *X* will use its own funds to purchase the land for $300,000. Prior to the issuance of the bonds, *CY* will file a statement with the Internal Revenue Service electing to treat the bonds as an exempt small issue of $10,000,000 or less under section 103(b)(6)(D) of the Internal Revenue Code.

X currently owns and operates a manufacturing facility in city *CI*, an incorporated municipality located in *CY*. During the 3 years prior to the issuance of the bonds, *X* will have expended $550,000 at the *CI* facility for research and experimental activities with respect to the proposed facility to be located in *CY*. The research and experimental activities will consist of experimentation with respect to the products to be produced in the new facility and the equipment to be used in the manufacture of such products.

X will expend $200,000 for wages to employees for qualified services and $175,000 for supplies to be used in the conduct of qualified research as part of the total research and experimental expenditures of $550,000. The amounts expended on wages and supplies are amounts described in section 30(b)(2)(A)(i) and (ii) of the Code relating to a credit for increasing research activities. *X* will claim a deduction for all $550,000 of the expenditures for research and experimental activities, under section 174 of the Code.

Situation 2.

County *CY* proposes to issue industrial development bonds on October 1, 1985, in the amount of $9,750,000 to finance the acquisition of land and the construction of a factory building in *CY* to be used by *X* corporation, a nonexempt person. The purchase price of the land will be less than 25 percent of the bond proceeds. Prior to the issuance of the bonds, *CY* will file a statement with the Internal Revenue Service electing to treat the bonds as an exempt small issue of $10,000,000 or less under section 103(b)(6)(D) of the Code.

X currently owns and operates facilities through subsidiary corporations in counties *G*, *H*, *I*, and *J* within the state. A portion of the proposed factory building in *CY* will be used by *X* for research and experimental activities. *X* plans to develop a new product for manufacture in its subsidiary corporations' manufacturing facilities in *G* and *I*. *X* plans to expend $300,000 for the research and experimental activities on behalf of the subsidiary corporations in *G* and *I*. *X* will not elect to treat the expenditures for research and experimental activities as deductible expense under the provisions of section 174 of the Code. *X* will capitalize such expenditures.

The manufacturing facilities in *G* will produce 70 percent of the new product to be manufactured and the facilities in *I* will produce the remaining 30 percent of the new product.

LAW

Section 103(a)(1) of the Code provides that gross income does not include interest on the obligations of a state or its political subdivisions.

Section 103(b)(1) of the Code provides that, except as otherwise provided in section 103(b), any industrial development bond will be treated as an obligation that is not described in section 103(a)(1).

Section 103(b)(6)(D) of the Code provides that, at the election of the issuer, section 103(b)(1) will not apply to any obligation issued as part of an issue if the aggregate authorized face amount of the issue is $10,000,000 or less and if substantially all (90 percent or more) of the proceeds of the issue are to be used for the acquisition, construction, reconstruction, or improvement of land or property of a character subject to the allowance for depreciation. To determine the aggregate authorized face amount of a bond issue, the face amount of the bonds to be issued, the outstanding face amount of certain prior exempt small issues, and the aggregate amount of capital expenditures for certain facilities must all be taken into account.

Section 103(b)(16)(A)(ii) of the Code provides that obligations will not qualify as exempt industrial development bonds under paragraphs (4), (5), or (6) of section 103(b) if 25 percent or more of the bond proceeds are to be used for the acquisition of land.

Section 1.103-10(b)(2)(ii) of the regulations generally defines an expenditure (regardless of how paid, whether in cash, notes, or stock in a taxable or nontaxable transaction) as a section 103(c)(6)(D) (redesignated as section 103(b)(6)(D)) capital expenditure if—

(a) The capital expenditure was financed other than out of the proceeds of issues taken into account under section 1.103-10(b)(2)(i)(a) of the regulations,

(b) The capital expenditures were paid or incurred during the 6-year period that begins 3 years before the date

of issuance of the issue in question and ends 3 years after such date,

(c) The principal user of the facility in connection with which the property resulting from the capital expenditures is used and the principal user of the facility financed by the proceeds of the issue in question is the same person or are two or more related persons (as defined in section 103(c)(6)(C) [redesignated as section 103(b)(6)(C)] of the Code and section 1.103-10(e) of the regulations),

(d) Both facilities referred to in (c) were (during the period described in (b) or a part thereof) located in the same incorporated municipality or in the same county (outside of the incorporated municipalities in such county), and

(e) The capital expenditures were properly chargeable to the capital account of any person or state or local government unit (whether or not such person is the principal user of the facility or a related person) determined, for this purpose without regard to any rule of the Code which permits expenditures properly chargeable to capital account to be treated as current expenses. With respect to obligations issued on or after August 8, 1972, determinations under the preceding sentence shall be made by including any expenditure which may, under any rule or election under the Code, be treated as a capital expenditure (whether or not such expenditure is so treated).

Section 103(b)(6)(F)(iv) of the Code provides that any capital expenditure described in clause (i) or (ii) of section 30(b)(2)(A) for which a deduction was allowed under section 174(a) shall not be taken into account in determining the aggregate authorized face amount of an issue.

Section 30(b)(2)(A) of the Code provides, in part, that the term "in-house research expenses" means (i) any wages paid or incurred to an employee for qualified services performed by such employee, and (ii) any amount paid or incurred for supplies used in the conduct of qualified research.

Section 174(a)(1) of the Code provides that a taxpayer may treat research or experimental expenditures that are paid or incurred during the taxable year in connection with the taxpayer's trade or business as expenses that are not chargeable to capital account. The expenditures so treated shall be allowed as a deduction.

In Rev. Rul. 77-27, 1977-1 C.B. 23, a political subdivision proposed to issue industrial development bonds in the amount of $4,500,000 to finance the acquisition of facilities to be located in county *M* for use by a nonexempt corporation. The corporation planned to expend $550,000 for research and experimentation with respect to the new facilities in county *M*. The corporation also owned and operated a facility in city *N*, an incorporated municipality located in county *M*. Rev. Rul. 77-27 holds that the expenditures by the corporation for research and experimentation will be capital expenditures within the meaning of section 103(b)(6)(D) of the Code with respect to the facilities to be located in county *M*.

In Rev. Rul. 77-253, 1977-2 C.B. 40, a political subdivision of a state issued $4,750,000 of industrial development bonds to finance the acquisition of land, a building, and equipment located in county *M*, to be used by *X* corporation, a nonexempt person. *X* also owns and operates manufacturing facilities through subsidiary corporations in counties *N*, *O*, *P*, and *Q*. *X* used the facilities in *M* for research and experimental activities to develop a new product for manufacture in *N* and *P*. Rev. Rul. 77-253 holds that the expenditures for research and experimental activities are section 103(b)(6)(D) capital expenditures with respect to the facilities in *N* and *P* where the new product is manufactured and not with respect to the facilities in *M* where the research and experimental activities were conducted. Rev. Rul. 77-253 amplified Rev. Rul. 77-27.

ANALYSIS

Situation 1.

Although *X* will elect to treat its expenditures for research and experimental activity as deductible expenses under section 174 of the Code, the provisions of section 1.103-10(b)(2)(ii)*(e)* of the regulations will apply for purposes of determining whether such expenditures are section 103(b)(6)(D) capital expenditures. However, under section 103(b)(6)(F)(iv), *X*'s capital expenditures for certain wages and supplies described in section 30(b)(2)(A)(i) and (ii) will not be treated as section 103(b)(6)(D) capital expenditures since those expenditures will be deducted under section 174. Therefore, *X* will not take $375,000 ($200,000 of wages and $175,000 of supplies) of the expenditures for research and experimental activity into account as a section 103(b)(6)(D) capital expenditure.

Situation 2.

X may elect to treat its proposed expenditures for research and experimental activity as capital expenditures or as deductible expenses. Regardless of *X*'s treatment of those amounts, the provisions of section 1.103-10(b)(2)(ii)*(e)* of the regulations will apply for purposes of determining whether such expenditures are section 103(b)(6)(D) capital expenditures. In addition, because *X* will not elect to treat its expenditures for research and experimental activity as deductible expenses under section 174(a) of the Code, none of the expenditures will be excluded under section 103(b)(6)(F)(iv) from treatment as section 103(b)(6)(D) capital expenditures.

HOLDING

Situation 1.

The expenditure of $300,000 by *X* for the land in *CY* is a section 103(b)(6)(D) capital expenditure. In addition, $175,000 of the $550,000 of expenditures by *X* for research and experimental activity is a section 103(b)(6)(D) capital expenditure. The expenditures for research and experimental activity must be taken into account with respect to the proposed facilities in *CY* and not with respect to the facilities in *CI* where the research and experimental activity will be conducted. Therefore, the aggregate authorized face amount of *CY*'s proposed bonds will be $9,975,000 ($9,500,000 face amount plus $300,000 and $175,000 of capital expenditures), and will not exceed the exempt small issue limitation.

Situation 2.

The proposed expenditures by *X* of $300,000 for research and experimental activities to be conducted in *CY* will be section 103(b)(6)(D) capital expenditures, but not with respect to the proposed manufacturing facilities to be lo-

cated in *CY*. Such expenditures will be section 103(b)(6)(D) capital expenditures with respect to the manufacturing facilities in *G* and *I*. The capital expenditures must be allocated to the facilities located in *G* and *I* on the basis of the percentage of production to be accomplished at each facility. Thus, $210,000 (70 percent of $300,000) of the total section 103(b)(6)(D) capital expenditures will be paid or incurred with respect to the facilities located in *G* and $90,000 (30 percent of $300,000) of the total section 103(b)(6)(D) capital expenditures will be paid or incurred with respect to the facilities located in *I*. The section 103(b)(6)(D) capital expenditures attributable to facilities in *G* and *I* must be aggregated with any outstanding exempt small issues under section 103(b)(6)(D) issued, within 3 years before or 3 years after the date of the capital expenditures, to finance facilities for use by the subsidiary corporations in the respective counties. The result will be the same if the research and experimental activities fail to develop a usable product. The aggregate authorized face amount of *CY*'s proposed bonds will be $9,750,000 and will not exceed the exempt small issue limitation.

EFFECT ON OTHER REVENUE RULINGS

Rev. Ruls. 77-27 and 77-253 are modified and superseded.

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26 CFR 1.103-10: Exemption for certain small issues of industrial development bonds.

Industrial development bonds; exempt small issue; capital expenditures. Installation of air conditioning benefiting tenants of the facility, other than the principal user, is a capital expenditure for purposes of section 103(b)(6)(D)(ii) of the Code.

Rev. Rul. 85-145

ISSUE

Is the installation of a $1,500,000 air conditioning system which benefits tenants other than a principal user a capital expenditure under section 130(b)(6)(D)(ii) of the Internal Revenue Code if the installation took place within 3 years before the issuance of an exempt small issue of bonds to finance new facilities for the principal user in the same city?

FACTS

Corporation *X* is engaged in the business of engineering, manufacturing, and marketing certain electrical products. *X*'s primary operations are currently conducted in one leased building located within city *CI* under a long term lease. As the principal user of the facility, *X* occupies more than 75 percent of the actual physical space in the leased building, although there are four other tenants accounting for the remaining space. Due to the nature of their businesses, the other tenants require air conditioning. *X* does not need nor want air conditioning. The owner-leasor, *L*, proposes to install a central air conditioning system solely designed to serve that portion of the building occupied by the other tenants. The system's installation will cost $1,500,000.

In order to meet expanded market demand for its products, *X* proposes to purchase land and erect a building at a different location in *CI*. The land and building (Project) will allow *X* to increase its overall production capacity. Upon completion of the Project, *X* will cancel the lease and vacate the leased building.

X has requested *CI* to issue an exempt small issue of industrial development bonds of $10,000,000 or less described in section 103(b)(6)(D) of the Code to finance the Project. *CI* had adopted a resolution expressing its intent to issue the bonds to finance *X*'s Project. Before the issuance of the bonds, *CI* will file a statement with the Internal Revenue Service electing to treat the bonds as an exempt small issue of $10,000,000 or less. At the time of issuance of the proposed bonds, *CI* will have no outstanding exempt small issues the proceeds of which were used to finance facilities for *X* or persons related to *X*.

X leased the building in *CI* of which it is now the principal user from corporation *L*, which is not related to *X*. *L* purchased the building more than 3 years before the proposed issuance date of *CI*'s bonds. However, within 3 years of the proposed issuance date of *CI*'s bonds, *L* will have completed the installation of the air conditioning system in the building.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on the obligations of a state or a political subdivision of a state.

Section 103(b)(1) of the Code provides that except as otherwise provided in section 103(b), any industrial development bond shall be treated as an obligation that is not an obligation described in section 103(a)(1).

Section 103(b)(6)(A) of the Code provides that section 103(b)(1) shall not apply to any obligation issued as part of an issue the aggregate authorized face amount of which is $1,000,000 or less and substantially all of the proceeds of which are to be used for the acquisition, construction, reconstruction, or improvement of land or property of a character subject to the allowance for depreciation, or to redeem part or all of a prior issue that was issued for such purposes.

Section 103(b)(6)(D) of the Code provides, in part, that the issuer may elect to issue an exempt small issue of $10,000,000 or less in lieu of the $1,000,000 described in section 103(b)(6)(A). For purposes of determining the aggregate face amount of such issue, there must be taken into account the face amount of the bonds to be issued, the outstanding face amount of any prior exempt small issues, and the aggregate amount of capital expenditures with respect to facilities paid or incurred during the 6-year period beginning three years before the date of such issue and ending three years after such date (and financed otherwise than out of the proceeds of outstanding issues to which section 103(b)(6)(A) applied). The facilities to be taken into account are those located in the same incorporated municipality or located in the same county (but not in any incorporated municipality) the principal user of which is or will be the same person or two or more related persons.

Section1.103-10(b)(2)(ii) of the Income Tax Regulations provides that an expenditure is a section 103(c)(6)(D) (redesignated as section 103(b)(6)(D)) capital expenditure if:

(a) The capital expenditure was financed other than out of the proceeds of issues taken into account,

(b) The capital expenditures were

paid or incurred during the 6-year period that begins 3 years before the date of issuance of the issue and ends 3 years after that date,

(c) The principal user of the facility in connection with which the property resulting from the capital expenditures is used and the principal user of the facility financed by the proceeds of the issue in question is the same person or two or more related persons,

(d) Both facilities referred to in (c) were located in the same incorporated municipality or in the same country (outside the incorporated municipalities in the county), and

(e) The capital expenditures were properly chargeable to the capital account of any person or state or local governmental unit (whether or not the person is the principal user of the facility or a related person).

In this case although *L* will not use tax-exempt bond proceeds to finance installation of the air conditioning system in the leased building, its purchase of the system will have been made within 3 years of the proposed issue date of *CI*'s bonds. Further, at the time of the proposed issuance of *CI*'s bonds, *X* will still be the principal user of *L*'s building even though not a direct user of the newly installed air conditioning system. Both the leased building and the facility to be bond-financed are in the same city and are used by the same principal user, *X*, and the cost of installation of the air conditioning system by *L* is a capital expenditure chargeable to *L*'s capital account. Therefore, the purchase of the air conditioning system by *L* satisfies the requirements of section 1.103-10(b)(2)(ii)(a) through (e) of the regulations.

HOLDING

The installation of an air conditioning system which benefits tenants of a facility other than the principal user of such facility is a capital expenditure with respect to such facility for purposes of section 103(b)(6)(D)(ii) of the Code and section 1.103-10(b)(2)(ii) of the regulations if the installation took place within 3 years of the issuance of an exempt small issue of bonds to finance new facilities for the principal user in the same city.

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26 CFR 1.103-13: Arbitrage bonds.

Government obligations; arbitrage bonds; refunding issue; tender offer. Acceptance of tender offers for previously issued bonds, which causes the proceeds of the refunding bonds to exceed the amount needed for the refunding, will not cause the refunding bonds to be arbitrage bonds.

Rev. Rul. 85-146

ISSUE

In a situation where a local government issues refunding bonds, where subsequent increases in interest rates cause large decreases in the market value of the previously issued bonds that are to be refunded, and where these decreases are so great that, if the holders of the previously issued bonds were to accept tender offers for their bonds, then the acceptances would cause the proceeds of the refunding bonds to exceed the amount needed for refunding the previous issue, will such a tender offer cause the refunding bonds to be arbitrage bonds under section 103(c) of the Internal Revenue Code?

FACTS

In October 1967 and December 1968, local government *CI* sold a total of 500x dollars of general obligation bonds (Bonds), which carried an interest rate of 5 percent. Currently, 400x dollars of these Bonds are outstanding.

In October 1978, *CI* sold 290x dollars of its Refunding Bonds carrying an interest rate of 9 percent pursuant to a common plan of financing. At the time of issuance of the Refunding Bonds, the proceeds received from issuance together with anticipated investment accumulations on the proceeds were projected to provide no more than enough funds to retire the 1967 and 1968 Bonds as soon as they would become callable. In October 1978, the 1967 and 1968 Bonds were being traded on the open market at prices which had fallen below par as a result of increases in interest rates. However, use of any portion of the Refunding Bond proceeds to purchase the 1967 and 1968 Bonds at market prices in October 1978 was not advantageous at that time.

CI invested the proceeds of the Refunding Bonds in United States Treasury obligations, State and Local Government Series (SLGS), at a yield that is not materially higher than the yie on the Refunding Bonds. *CI* h matched the maturities on the SLG obligations with the requirements f debt service of the escrow account. U der the terms of the escrow *CI* could its option redeem SLGS and use t proceeds of the redemption to purcha by tender offer any of the outstandi 1968 Bonds, provided that the amoun remaining in the escrow accounts aft a tender offer purchase were sufficie to retire the remaining outstandi 1967 and 1968 Bonds.

Because of increases in interest rat since the issuance of the Refundi Bonds, the market value of the ou standing 1967 and 1968 Bonds ha been further depressed. *CI* has dete mined that a consolidation of its ou standing Bonds would be beneficial this time. Therefore, *CI* is now consi ering the purchase at fair market valu below par, of certain of the outstandi 1967 and 1968 Bonds. Specifically, proposes to advertise, or have the ban that is trustee under the escrow agre ments advertise, for tenders for sale the outstanding 1967 and 1968 Bond that were to be eventually refunded b the Refunding Bonds. *CI* will accep those offers that it deems advantageou and advisable.

In accord with its expectations at th time of issuance of the Refundin Bonds, *CI* will assure that after C completes its tender offer purchases o outstanding Bonds, the yield on th SLGS obligations remaining in the es crow accounts will continue to be no materially higher than the yield on th Refunding Bonds. Because *CI* expect to purchase some of the outstandin 1967 and 1968 Bonds at prices de pressed far below par, the amount re maining in the escrow accounts afte the purchase will exceed the amoun needed to discharge the remaining out standing 1967 and 1968 Bonds. There fore, *CI* will transfer the excess amoun from the escrow account into its gen eral fund for immediate expenditure fo general municipal purposes.

LAW AND ANALYSIS

Section 103(a) of the Code provide that gross income does not include in terest on the obligations of a state or its political subdivision. However, sectio 103(c) of the Code generally provide

that any arbitrage bond shall not be treated as an obligation described in section 103(a).

Section 103(c)(2) of the Code defines an arbitrage bond as any obligation that is issued as part of an issue all or a major portion of the proceeds of which are reasonably expected to be used directly or indirectly (A) to acquire securities or obligations that may be reasonably expected at the time of issuance of the issue, to produce a yield over the term of the issue that is materially higher than the yield on obligations of the issue or (B) to replace funds that were used directly or indirectly to acquire securities or obligations described in section 103(c)(2)(A).

Section 1.103-13(a)(2)(i) provides that the determination whether an obligation is an arbitrage bond depends on the issuer's reasonable expectations as of the date of issue regarding the amount and use of the proceeds of the issue.

Section 1.103-15(a) of the regulations provides the general rule that with certain exceptions if the excess proceeds of a refunding issue exceed 1 percent of the original proceeds, the refunding obligations are arbitrage bonds. Excess proceeds of a refunding issue are defined generally to include all proceeds, including investment proceeds, excepting certain proceeds enumerated in section 1.103-15(b) of the regulations.

Because it is common knowledge that market rates of interest vary from time to time, it may be assumed that, as of the issuance of any issue of refunding bonds, the issuer may have a reasonable expectation that future increases in interest rates are a possibility. Further, such an issuer would normally understand that rate increase would tend to depress all bond prices and therefore could make possible the advantageous purchase of some of the original bonds. Conversely, the issuer would ordinarily not know with certainty that interest rates would in fact increase.

It was foreseeable by *CI* that, sometime after the 1978 issuance, market rates of interest might eventually increase, which would tend to depress the prices of *CI*'s outstanding bonds. However, the foreseeability in 1978 of the possible opportunity to make advantageous purchases in some later year did not require a reduction in the size of the 1978 Refunding Bond issue. At the time of the1978 issuance, *CI* could not be certain that market rates of interest would eventually increase sufficiently to actually make any advantageous purchases of its outstanding 1967 and 1968 Bonds possible. Therefore, it was appropriate for purposes of section 103(c) to issue the Refunding Bonds in an amount that was based on an assumption that no open-market purchases would be made.

The actual purchase of 1967 and 1968 Bonds below par will result in excess funds in the refunding escrow. But this fact will not cause the 1978 Refunding Bonds to be arbitrage bonds because the yield on the obligations remaining in the escrow account for the outstanding bonds after *CI* completes its tender offer purchases will not be materially higher than the combined yield on the Refunding Bonds.

HOLDING

In a situation where a local government issues refunding bonds, where subsequent increases in interest rates cause large decreases in the market value of the previously issued bonds that are to be refunded, and where these decreases are so great that, if the holders of the previously issued bonds were to accept tender offers for their bonds, then the acceptances would cause the proceeds of the refunding bonds to exceed the amount needed for refunding the previous issue, such a tender offer will not cause the refunding bonds to be arbitrage bonds under section 103(c) of the Code.

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26 CFR 1.103-13: Arbitrage bonds.

Arbitrage bonds; residential rental project. Bonds will be arbitrage bonds, within the meaning of section 103(c)(2) of the Code, if a city's certification is made in bad faith and it is reasonable to expect the bond proceeds will be invested in materially higher yielding obligations. Section 103(b)(4)(A) does not apply to an issue of industrial development bonds with the stated purpose of providing a residential rental project if the facts indicated that the bond proceeds will not be so used.

Rev. Rul. 85-182

ISSUES

1. If the facts surrounding an issuance of bonds by a city indicate (a) that the city's certification of its expectations with respect to the amount and use of the bond proceeds was made in bad faith and (b) that the issuer's reasonable expectations were that the bond proceeds would be invested in materially higher yielding obligations, are the bonds arbitrage bonds within the meaning of section 103(c)(2) of the Internal Revenue Code?

2. If the stated purpose of an issue of industrial development bonds is to provide a residential rental project within the meaning of section 103(b)(4)(A) but the facts surrounding the issuance indicate that substantially all of the proceeds will not be so used, does section 103(b)(4)(A) apply to the bonds?

FACTS

City *CI* issued bonds in the amount of 350*x* dollars. At the time of issuance, *CI* certified that (1) the proceeds of the issue would be loaned to *X*, a nonexempt person, to finance the construction in *CI* of a project for residential rental property described in section 103(b)(4)(A) of the Code, (2) the project would consist of approximately *y* residential units, and (3) *X* would lease the completed residential units in the project to qualifying tenants. *CI* covenanted in the bond indenture that it would meet the requirements of section 1.103-14(b) of the Income Tax Regulations concerning temporary investment of the proceeds at a materially higher yield.

Pursuant to the bond indenture, the bond proceeds were invested in certificates of deposit and were held as security for the bondholders. The yield on the certificates of deposit is materially higher than the yield on the bonds. The bond indenture provides that the bond trustee cannot loan the proceeds to *X* until alternate security for the issue in the form of a letter of credit from a foreign bank is obtained. The alternate security must be sufficient to enable the bonds to maintain a satisfactory credit rating. The bond indenture provides that if the alternate security for the issue is not obtained within 3 years of

the date of issue, *CI* must redeem all the bonds.

X will not begin construction of the project until it has been loaned the proceeds of the bonds. Consequently, if *CI* redeems the bonds prior to the loan, *X* will not suffer a financial detriment.

The bond trustee is authorized to pay issuance costs of 25*x* dollars, including issuer's, bond counsel's, and underwriters' fees. Earnings on the certificates of deposit during the initial 3-year period are sufficient to pay all issuance costs as well as the interest on the bonds. As a result, *CI* will incur no costs with respect to the issue.

The indenture provides that after a letter of credit is secured and the proceeds are loaned to *X*, payment of debt service (principal and interest) on the bonds is to be secured by the remaining proceeds, the property, and the semiannual payments *X* will make to *CI*. *X*'s payments to *CI* are to be equal to the semiannual payments of debt service on the bonds.

Within 6 months of the date of issue, *CI* incurred a substantial binding obligation, within the meaning of section 1.103-14(b)(3) of the regulations, to acquire the land on which the project is to be located in an amount which is de minimis relative to the size of the issue.

The population of the greater metropolitan area of *CI* is such that the contemplated increase in *CI*'s housing stock of *y* residential units is out of proportion to the population figure.

The average cost of each residential rental unit to be constructed is substantially greater than not only the average cost of construction of residential rental units in the *CI* metropolitan area during the past 3 years, but also the average cost during that period of new single family, owner-occupied residences.

CI's total outstanding indebtedness issued in the 8 years preceding the date of issue totaled 165*x* dollars, 35*x* dollars of which were tax exempt industrial development bonds.

For a residential rental project of this type, the customary financial practice would be to obtain, prior to the issuance of bonds, either a letter of credit, a commitment or guaranty for the issuance of a letter of credit, or some other credit support. However, *CI* did not obtain a commitment or guaranty for the issuance of a letter of credit prior to issuance of the bonds. It is likely that it will be difficult to obtain a letter of credit to support this project.

LAW AND ANALYSIS

Issue 1

Section 103(a) of the Code provides that gross income does not include interest on the obligations of a state or a political subdivision of a state.

Section 103(c)(1) of the Code provides, generally, that the interest on any arbitrage bond will not be excludable from gross income.

Section 103(c)(2) of the Code provides that the term "arbitrage bond" means any obligation that is issued as part of an issue all or a major portion of the proceeds of which are reasonably expected to be used directly or indirectly (A) to acquire securities or obligations that may be reasonably expected at the time of issuance of the issue, to produce a yield over the term of the issue that is materially higher than the yield on obligations of the issue, or (B) to replace funds that were used directly or indirectly to acquire securities or obligations described in section 103(c)(2)(A).

Section 103(c)(4)(A) of the Code provides that an obligation shall not be treated as an arbitrage bond solely by reason of the fact that the proceeds of the issue of which the obligation is a part may be invested for a temporary period in securities or other obligations until the proceeds are needed for the purpose for which the issue was issued.

Section 1.103-13(a)(2)(i) of the regulations provides that the determination whether an obligation is an arbitrage bond depends on the issuer's reasonable expectations, as of the date of issue, regarding the amount and use of the proceeds of the issue. An obligation is not an arbitrage bond if, based on the issuer's reasonable expectations on the date of issue, the proceeds will not be used in a manner that would cause the obligation to be an arbitrage bond under section 103(c)(2) of the Code and sections 1.103-13, 1.103-14, and 1.103-15 of the regulations. Reasonable expectations as to future events may be established to the extent permitted by section 1.103-13(a)(2)(ii).

Section 1.103-13(a)(2)(ii)(A) of the regulations permits an issuer to certify in the bond indenture or related documents its reasonable expectations on the date of issue as to future events. Section 1.103-13(a)(20)(ii)(D) requires that the issuer certify the facts and circumstances on which its expectations are based. In addition, the issuer must certify that its expectations are reasonable. Section 1.103-13(a)(2)(ii)(F) provides that a proper certification is not affected by subsequent events. Consequently, bonds will not be arbitrage bonds solely because of the occurrence of an event after issuance of the bonds that was not reasonably expected at the time of the issue.

Section 1.103-13(a)(2)(iv) of the regulations provides that if a certification contains a material misrepresentation, the Commissioner may disqualify the issuer. An issuer that is disqualified may not certify an issue under section 1.103-13(a)(2)(ii). The disqualification of an issuer will not affect bonds issued prior to the disqualification.

The purpose of the certification provisions in the regulations is to permit the issuer to provide certainty to the purchasers of the bonds regarding the facts that determine whether the bonds are arbitrage bonds. These provisions, however, do not permit an issuer to make a certification of expectations in bad faith. Bad faith is present where the likelihood of completion of the project as contemplated is remote. *Compare* Rev. Rul. 80-91, 1980-1 C.B. 30, Rev. Rul. 80-92, 1980-1 C.B. 31, and Rev. Rul. 80-188, 1980-2 C.B. 47.

The facts of this case indicate that the likelihood of completing the project as contemplated is remote. The facts which so indicate include: (1) the size of the project relative to the population of *CI*, (2) issuance without the credit support necessary to permit use of the proceeds for the construction of residential rental property, (3) the difficulty that is likely to be incurred in obtaining the required credit support, (4) the provision for redemption of the bonds at the end of 3 years if credit support is not secured, (5) earnings on the certificates of deposit sufficient to pay all costs of issuance, (6) costs of construction far in excess of the average cost of other housing in *CI*, and (7) an issue the size of which is grossly disproportionate to both the size of the indebtedness *CI* issued in the several years immediately prior to the issue and

the aggregate amount of industrial development bonds issued in that period.

Because *CI*'s certification was made in bad faith, *CI* cannot rely on the certification.

CI reasonably expected to use all or a major portion of the proceeds to acquire obligations with a materially higher yield than the yield on the bonds. The bonds do not fall within the exception provided in section 103(c)(4)(A) of the Code for temporary investment of the proceeds. Accordingly, the bonds are arbitrage bonds within the meaning of section 103(c)(2). In addition, the Commissioner may disqualify *CI* pursuant to section 1.103-13(a)(20)(iv) of the regulations because of the material misrepresentation in *CI*'s certificate.

Issue 2

Section 103(b)(1) of the Code provides generally that industrial development bonds are not described in section 103(a) and the interest paid with respect to these bonds will not be excludable from gross income. Section 103(b)(4)(A) of the Code and section 1.103-8(a)(1) of the regulations provide that the interest on an industrial development bond to provide projects for residential rental property will be excluded from gross income if substantially all (90 percent or more) of the bond proceeds are to be used to provide the facilities.

The facts of this case noted above also indicate that substantially all of the proceeds of the issue will not be used to provide a project for residential rental property within the meaning of section 103(b)(4)(A) of the Code. Accordingly, *CI*'s bonds will not meet the requirements of section 103(b)(4)(A), and the interest on the industrial development bonds will not be excludable from gross income.

HOLDING

Issue 1. If the facts surrounding an issue indicate (a) that the issuer's certification was made in bad faith and (b) that the issuer's reasonable expectations were that the proceeds would be invested in securities or obligations reasonably expected at the time of issuance to produce a yield over the term of the issue materially higher than the yield on the issue, then the bonds are arbitrage bonds within the meaning of section 103(c) of the Code.

Issue 2. If the stated purpose of an issue of industrial development bonds is to provide a residential rental project within the meaning of section 103(b)(4)(A) of the Code, but the facts surrounding the issuance indicate that substantially all of the proceeds will not be so used, then section 103(b)(4)(A) does not apply to the bonds.

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26 CFR 1.103-14: Temporary investments, reserve funds, and refunding issues.

Procedures for requesting letter rulings under section 103(c) of the Code regarding the method of valuation of acquired obligations in "reasonably required reserve or replacement funds." See Rev. Proc. 85-38, page 442.

Section 103A.—Mortgage Subsidy Bonds

26 CFR 1.103A-2: Qualified mortgage bond.

T.D. 8049

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, SUBCHAPTER H, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 6a—TEMPORARY REGULATIONS UNDER TITLE 11 OF THE OMNIBUS RECONCILIATION ACT OF 1980; PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Information Reporting for Mortgage Subsidy Bonds

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that relate to the tax exempt status of mortgage subsidy bonds. Changes to the applicable tax law were made by the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. These regulations affect all purchasers, beneficiaries, and governmental issuers of tax exempt mortgage subsidy bonds.

DATES: These regulations are effective with respect to mortgage subsidy bonds issued after December 31, 1984 except that the regulations relating to qualified veterans' mortgage bonds are effective for obligations issued after July 18, 1984.

FOR FURTHER INFORMATION CONTACT: Mitchell H. Rapaport of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3740).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On December 12, 1984, the FEDERAL REGISTER published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 103A(j)(3), (4), and (5) of the Internal Revenue Code of 1954 (49 FR 48323) [LR-240-84, 1985-1 C.B. 658]. The amendments were, in part, proposed to conform the regulations to section 611(b) of the Tax Reform Act of 1984 (Pub. L. 98-369; 98 Stat. 901) [1984-3 C.B. (Vol. 1) 1, 409]. A public hearing was held on April 30, 1985. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision. In addition, the regulations adopted by this Treasury decision supersede the temporary regulations under section 103A(j)(3), (4), and (5). Accordingly, those portions of the Temporary Regulations under Title 11 of the Omnibus Reconciliation Act of 1980 [Pub. L. 96-499, 1980-2 C.B. 509] relating to the changes made by section 611(b) of the Tax Reform Act are removed and replaced with a cross-reference to the rules adopted by this Treasury decision.

EXPLANATION OF PROVISIONS

Section 103(a) provides that gross income does not include interest on the obligations of a State or political subdivision thereof. Section 103A provides that any mortgage subsidy bond shall be treated as an obligation not described in section 103(a). However, qualified mortgage bonds and qualified veterans' mortgage bonds are not treated as mortgage subsidy bonds. Section 611 of the Tax Reform Act added several requirements to the definition of qualified mortgage bond and qualified veterans' mortgage bond.

PUBLIC COMMENTS

Many commentators objected to the extent of the information required to be reported with respect to each beneficiary of the proceeds of an issue (*i.e.*, each recipient of a mortgage loan provided with the proceeds of an issue). In response to these comments, the regulations have been revised to require the reporting of significantly less information. In addition, the regulations adopt the suggestion that information be reported on an aggregate basis, rather than with respect to each recipient of a mortgage loan. It is believed that information collected with respect to each recipient of a mortgage loan may be useful to the government in assessing the mortgage bond and mortgage credit certificate programs. Nevertheless, due to practical considerations, including the requirement of section 611(d)(7) of the Tax Reform Act of 1984, that the Secretary of the Treasury, in consultation with the Secretary of Housing and Urban Development, submit a report concerning these programs to Congress by January 1, 1987, it has been decided to require the reporting of data on an aggregate basis.

As revised, the regulations require information reporting with respect to the number of loans and aggregate principal amount of the loans categorized according to (1) the borrowers' income, (2) the acquisition cost of the residences acquired, (3) whether the borrowers have satisfied the 3-year requirement, and (4) whether the residences are located in targeted areas. With respect to qualified home improvement and rehabilitation loans, the only information required to be reported is the number and aggregate loan amount of such loans and whether the loans are with respect to residences located in targeted areas. Similar information is to be collected with respect to mortgage credit certificates. See §1.25-4T(e). This information is being collected in response to section 611(d)(7) of the Tax Reform Act of 1984 which requires that the Secretary of the Treasury submit a report to Congress by January 1, 1987, regarding the performance of issuers of qualified mortgage bonds and mortgage credit certificates relative to the intent of Congress described in section 103A(j)(5).

Some commentators objected to the extent of information required to be reported with respect to qualified veterans' mortgage bonds on the grounds that such information is not relevant to qualified veterans' mortgage bonds because such bonds are not subject to all of the statutory requirements imposed on qualified mortgage bonds. Although information concerning income, acquisition cost, and the 3-year requirement is not relevant to any statutory requirement imposed on qualified veterans' mortgage bonds, the collection of such information pursuant to section 103A(j)(3)(A) is relevant to an evaluation of the qualified veterans' mortgage bond program. Accordingly, the final regulations require information reporting on qualified veterans' mortgage bonds with respect to the number of loans and the aggregate principal amounts of the loans categorized according to (1) the borrowers' income, (2) the acquisition cost of the residences acquired, and (3) whether the borrowers have satisfied the 3-year requirement.

Several commentators stated that the regulations should be amended to make clear that the information required to be reported is information as of the date such information is required to be submitted and is not affected by later events. Similarly, it was suggested that the State certification requirement of section 103A(j)(4) should not require officials to certify as to matters that could change in the future. These suggestions have been adopted.

Commentators suggested that the information reporting requirement should apply only to mortgages provided with the original proceeds of an issue. This suggestion has been adopted. Thus, for example, reporting would not be necessary with respect to assumptions of mortgage loans.

Many commentators objected to the requirement that information be submitted on magnetic media. Accordingly, the regulations as revised do not require reporting on magnetic media.

A number of commentators stated that the regulations did not define the term "beneficiary" and that the regulations implied that it was necessary to file more than one report where, for example, a husband and a wife jointly obtain a mortgage. In addition, commentators stated that only the income of the borrower, and not the income of all the members of the borrower's family, is the relevant information for purposes of section 103A. Accordingly, the regulations have been revised to require reporting with respect to the "borrowers" of the original proceeds.

In response to public comments, the regulations no longer require data on borrower income to be collected under the definition used for purposes of section 8 of the Housing Act of 1937, as amended. Instead, annualized gross monthly income, as reported by borrowers on standard loan documents, is to be reported. In addition, issuers are not required to check the accuracy of information collected by examining borrowers' tax returns. Similarly, in determining whether a borrower acquiring a residence in a targeted area satisfies the 3-year requirement, the issuer may rely on a statement signed by the borrower.

Commentators indicated that issuers should not be responsible for submitting false information provided to them by mortgagors. This suggestion has been adopted.

A number of commentators stated that the regulations require excessive and redundant information to be included in the policy statement as described in section 103A(j)(5). In response to these comments, the regulations have been revised to make clear that the provisions describing the information to be included in the policy statement are intended merely as examples of the types of information that an issuer may include in its policy statement; thus, there is no requirement that all such information be provided. In addition, in response to comments, the definitions of "low", "moderate", and "median" income for purposes of providing information in the policy statement have been revised.

Several commentators stated that there is no statutory requirement that issuers indicate in the policy statement their "goals" with respect to housing, development, and low-income housing assistance. Accordingly, the regulations as revised do not require issuers to indicate their goals with respect to these matters.

The proposed regulations provided that issuers that did not issue qualified

mortgage bonds in a particular year and did not reasonably expect to issue qualified mortgage bonds in the following year would not be precluded from issuing qualified mortgage bonds in the following year if a policy statement is filed prior to the date of issue. In response to public comments, the final regulations provide that this provision will apply if the issuer did not reasonably expect to issue qualified mortgage bonds during the following year, regardless of whether it issued bonds in the current year.

Commentators stated that the requirement that the notice of hearing summarize the policy statement is unnecessary and adds to the expense of providing such notice. In response to this comment the regulations have been revised to require only that the notice contain a statement that the hearing will involve the issuer's policies with respect to housing, development, and low-income housing assistance which the issuer is to follow in issuing qualified mortgage bonds and mortgage credit certificates.

In response to public comments, the periods covered by the reports relating to the use of proceeds and the periods for assessing compliance with the statements of policy have been modified. In general, as modified, these periods end each year on June 30.

With respect to the State certification requirement, commentators stated that the rule permitting an issuer, after a 30 day waiting period, to self-certify that an issue satisfies the requirements of section 103A(g) requires too long a period of time to elapse before the issuer may execute this certification. In response to this comment, this rule has been modified so as to permit the issuer to execute this certification after 15 days.

In response to public comments, the regulations have been revised to make clear that the State certification must be executed on or before the date of issue.

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis therefore is not required.

REGULATORY FLEXIBILITY ANALYSIS

Although a notice of proposed rulemaking that solicited public comment was issued, the Internal Revenue Service concluded when that notice was issued that the regulations are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, the final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

PAPERWORK REDUCTION ACT

The collection of information requirements contained in these regulations have been submitted to the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB under control number 1545-0720.

DRAFTING INFORMATION

The principal author of these proposed regulations is Mitchell H. Rapaport of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

* * * * *

Amendments to the regulations

For the reasons set out in the preamble, Part 1, Part 6a, and Part 602 of Title 26 of the Code of Federal Regulations are amended as follows:

Paragraph 1. The authority for Part 1 is amended to read in part:

Authority: 26 U.S.C. 7805. * * * Section 1.103A-2(k), (l), and (m) also issued under 26 U.S.C. 103A(j)(3), (4), and (5). * * *

Par. 2. New §1.103A-2 is added immediately following §1.103(n)-7T to read as follows:

§1.103A-2 Qualified mortgage bond.

(a)-(j) (Reserved)

(k) *Information reporting requirement*—(1) *In general.* An issue meets the requirements of this paragraph only if the issuer in good faith attempted to meet the information reporting requirements of this paragraph. Except as otherwise provided in paragraph (k)(5)(iv), the requirements of this paragraph apply to qualified veterans' mortgage bonds issued after July 18, 1984, and to qualified mortgage bonds issued after December 31, 1984.

(2) *Information required.* (i) The issuer must, based on information and reasonable expectations determined as of the date of issue submit on Form 8038 the information required therein; the issuer need not however, include the information required by Form 8038 that is relevant only to obligations described in section 103(a)(1) and the regulations thereunder. The information that must be submitted includes—

(A) The name, address, and employer identification number of the issuer,

(B) The date of issue,

(C) The face amount of each obligation which is part of the issue,

(D) The total purchase price of the issue,

(E) The amount allocated to a reasonably required reserve or replacement fund,

(F) The amount of lendable proceeds,

(G) The stated interest rate of each maturity,

(H) The term of each maturity,

(I) In the case of an issue of qualified mortgage bonds, whether the issuer has elected under section §6a.103A-2(i)(4)(v) to pay arbitrage to the United States,

(J) In the case of an issue of qualified mortgage bonds, the issuer's market limitation as of the date of issue (as defined in §6a.103A-2(g)), the amount of qualified mortgage bonds that the issuer has elected not to issue under section 25(c)(2) and the regulations thereunder, and the aggregate amount of qualified mortgage bonds issued to date by the issuer during the calendar year, and

(K) In the case of an issue of qualified veterans' mortgage bonds, the issuer's State veterans limit (as defined in section 103A(o)(3)(B) and the regulations thereunder) and the aggregate amount of qualified veterans' mortgage bonds issued to date by the issuer during the calendar year and prior to the date by the issuer during the calendar year and prior to the date of issue of

the issue for which the Form 8038 is being submitted.

(ii) With respect to issues issued after December 31, 1984, the issuer must submit a report containing information on the borrowers of the original proceeds of such issues. The report must be filed for each reporting period in which the original proceeds of any of such issues are used to provide mortgages. The issuer is not responsible for false information provided by a borrower if the issuer did not know or have reason to know that the information was false. The report must be filed on the form prescribed by the Internal Revenue Service. If no form is prescribed, or if the form prescribed is not readily available, the issuer may use its own form provided that such form is in the format set forth in paragraph (k)(3) and contains the information required by this paragraph (k)(2)(ii). The report must be titled "Qualified Mortgage Bond Information Report" or "Qualified Veterans' Mortgage Bond Information Report", and must include the name, address, and TIN of the issuer, the reporting period for which the information is provided, and the following tables containing information concerning the borrowers of the original proceeds of the issues subject to the requirements of this paragraph (k)(2)(ii) with respect to mortgages provided during the reporting period for which the report is filed:

(A) A table titled "Number of Mortgage Loans by Income and Acquisition Cost" showing the number of mortgage loans (other than those issued in connection with qualified home improvement and rehabilitation loans) made during the reporting period according to the annualized gross income of the borrowers (categorized in the following intervals of income: $0-$9,999; $10,000-$19,999; $20,000-$29,999; $30,000-39,999; $40,000-$49,999; $50,000-$74,999; and $75,000 or more) and according to the acquisition cost of each residence being financed (categorized in the following intervals of acquisition cost: $0-$19,999; $20,000-$39,999; $40,000-$59,999; $60,000-$79,999; $80,000-$99,999; $100,000-$119,999; $120,000-$149,999; $150,000-$199,999; and $200,000 or more). For each interval of income and acquisition cost the table must also be categorized according to the number of borrowers that—

(1) Did not have a present ownership interest in a principal residence at any time during the 3-year period ending on the date the mortgage is executed (*i.e.*, satisfied the 3-year requirement) and purchased residences in targeted areas,

(2) Satisfied the 3-year requirement and purchased residences not located in targeted areas,

(3) Did have a present ownership interest in a principal residence at any time during the 3-year period ending on the date the mortgage is executed (*i.e.*, did not satisfy the 3-year requirement) and purchased residences in targeted areas, and

(4) Did not satisfy the 3-year requirement and purchased residences not located in targeted areas.

With respect to issues of qualified veterans' mortgage bonds, for each interval of income and acquisition cost the table need only be categorized according to the number of borrowers that satisfied the 3-year requirement and the number of borrowers that failed to satisfy the 3-year requirement.

(B) A table titled "Volume of Mortgage Loans by Income and Acquisition Cost" showing the total principal amount of the mortgage loans (other than qualified home improvement and rehabilitation loans) provided during the reporting period according to annualized gross income (categorized in the same intervals of income as the preceding table) and according to the acquisition cost of the residences acquired (categorized in the same acquisition cost intervals as the preceding table). For each interval of income and acquisition cost the table must also be categorized according to the total principal amount of the mortgage loans of borrowers that—

(1) Satisfied the 3-year requirement and purchased residences in targeted areas,

(2) Satisfied the 3-year requirement and purchased residences not located in targeted areas,

(3) did not satisfy the 3-year requirement and purchased residences in targeted areas, and

(4) Did not satisfy the 3-year requirement and purchased residences not located in targeted areas.

With respect to issues of qualified veterans' mortgage bonds, for each interval of income and acquisition cost the table need only be categorized according to the total principal amount of the mortgage loans of borrowers that satisfied the 3-year requirement and the total principal amount of the mortgage loans of borrowers that did not satisfy the 3-year requirement.

(C) For issues other than qualified veterans' mortgage bonds, a table titled "Mortgage Subsidy Bonds for Qualified Home Improvement and Rehabilitation Loans" showing the number of borrowers obtaining qualified home improvement loans and qualified rehabilitation loans and the total of the principal amounts of such loans; the information contained in the table must also be categorized according to whether the residences with respect to which the loans were provided are located in targeted areas.

(3) *Format.* (i) With respect to the report required by paragraph (k)(2)(ii), if no form is prescribed by the Internal Revenue Service, or if the prescribed form is not readily available, the issuer must submit the report in the format specified in this paragraph (k)(3).

(ii) With respect to issues of qualified mortgage bonds the format of the report specified in paragraph (k)(3) is the following:

QUALIFIED MORTGAGE BOND INFORMATION REPORT

Name of issuer:
Address of issuer:
TIN of issuer:
Reporting period:

NUMBER OF MORTGAGE LOANS BY INCOME AND ACQUISITION COST

3-year Requirement:	*Satisfied*		*Not Satisfied*		*Totals*
Annualized Gross Monthly Income of Borrowers	Nontargeted Area	Targeted Area	Nontargeted Area	Targeted Area	
$ 0 - 9,999					
$ 10,000 - 19,999					
$ 20,000 - 29,999					
$ 30,000 - 39,999					
$ 40,000 - 49,999					
$ 50,000 - 74,999					
$ 75,000 or more					
Total					
Acquisition Cost					
$ 0 - 19,999					
$ 20,000 - 39,999					
$ 40,000 - 59,999					
$ 60,000 - 79,999					
$ 80,000 - 99,999					
$100,000 - 119,999					
$120,000 - 149,999					
$150,000 - 199,999					
$200,000 or more					
Total					

VOLUME OF MORTGAGE LOANS BY INCOME AND ACQUISITION COST

3-year Requirement:	*Satisfied*		*Not Satisfied*		*Totals*
Annualized Gross Monthly Income of Borrowers	Nontargeted Area	Targeted Area	Nontargeted Area	Targeted Area	
$ 0 - 9,999					
$ 10,000 - 19,999					
$ 20,000 - 29,999					
$ 30,000 - 39,999					
$ 40,000 - 49,999					
$ 50,000 - 74,999					
$ 75,000 or more					
Total					
Acquisition Cost					
$ 0 - 19,999					
$ 20,000 - 39,999					
$ 40,000 - 59,999					
$ 60,000 - 79,999					
$ 80,000 - 99,999					
$100,000 - 119,999					
$120,000 - 149,999					
$150,000 - 199,999					
$200,000 or more					
Total					

MORTGAGE SUBSIDY BONDS FOR QUALIFIED HOME IMPROVEMENT AND REHABILITATION LOANS

	Nontargeted Area	Targeted Area	Totals
Number of qualified home improvement loans			
Volume of qualified			

MORTGAGE SUBSIDY BONDS FOR QUALIFIED HOME IMPROVEMENT AND REHABILITATION LOANS

	Nontargeted Area	Targeted Area	Totals
home improvement loans			
Number of qualified rehabilitation loans			
Volume of qualified rehabilitation loans			

(iii) The format of the report specified in paragraph (k)(3) for qualified veterans' mortgage bonds is the following:

QUALIFIED VETERANS' MORTGAGE BOND INFORMATION REPORT

Name of issuer:
Address of issuer:
TIN of issuer:
Reporting period:

NUMBER OF MORTGAGE LOANS BY INCOME AND ACQUISITION COST

3-year Requirement: Annualized Gross Monthly Income of Borrowers	*Satisfied*	*Not Satisfied*	*Totals*
$ 0 - 9,999			
$ 10,000 - 19,999			
$ 20,000 - 29,999			
$ 30,000 - 39,999			
$ 40,000 - 49,999			
$ 50,000 - 74,999			
$ 75,000 or more			
Total			
Acquisition Cost			
$ 0 - 19,999			
$ 20,000 - 39,999			
$ 40,000 - 59,999			
$ 60,000 - 79,999			
$ 80,000 - 99,999			
$100,000 - 119,999			
$120,000 - 149,999			
$150,000 - 199,999			
$200,000 or more			
Total			

VOLUME OF MORTGAGE LOANS BY INCOME AND ACQUISITION COST

3-year Requirement: Annualized Gross Monthly Income of Borrowers	*Satisfied*	*Not Satisfied*	*Totals*
$ 0 - 9,999			
$ 10,000 - 19,999			
$ 20,000 - 29,999			
$ 30,000 - 39,999			
$ 40,000 - 49,999			
$ 50,000 - 74,999			
$ 75,000 or more			
Total			
Acquisition Cost			
$ 0 - 19,999			
$ 20,000 - 39,999			
$ 40,000 - 59,999			
$ 60,000 - 79,999			
$ 80,000 - 99,999			
$100,000 - 119,999			
$120,000 - 149,999			
$150,000 - 199,999			
$200,000 or more			
Total			

(4) *Definitions and special rules.* (i) For purposes of this paragraph the term "annualized gross income" means the borrower's gross monthly income multiplied by 12. Gross monthly income is the sum of monthly gross pay, any additional income from investments, pensions, Veterans Administration (VA) compensation, part-time employment, bonuses, dividends, interest, current overtime pay, net rental income, etc., and other income (such as alimony and child support, if the borrower has chosen to disclose such income). Information with respect to gross monthly income may be obtained from available loan documents, *e.g.*, the sum of lines 23D and 23E on the Application for VA or FmHA Home Loan Guaranty or for HUD/FHA Insured Mortgage (VA Form 26–1802a, HUD 92900, Jan. 1982), or the total line from the Gross Monthly Income section of FHLMC Residential Loan Application form (FHLMC 65 Rev. 8/78). With respect to obligations issued prior to October 1, 1985, issuers may submit data based on annualized gross income or, instead, based on the adjusted income (as defined in §1.167(k)-3(b)(3)) of the mortgagor's family for the previous calendar year. If data is submitted based on adjusted income, the issuer must note this fact in the report.

(ii) For purposes of this paragraph, the term "reporting period" means the following periods:

(A) The period beginning January 1, 1985, and ending on September 30, 1985,

(B) The period beginning on October 1, 1985, and ending on June 30, 1986, and

(C) After June 30, 1986, each 1-year period beginning July 1 and ending June 30.

(iii) See the regulations under section 103(1) for the definitions of the terms "date of issue", "maturity", and "term of issue".

(iv) For purposes of this paragraph, verification of information concerning a borrower's gross monthly income with other available information concerning the borrower's income (*e.g.*, Federal income tax returns) is not required. In determining whether a borrower acquiring a residence in a targeted area satisfies the 3-year requirement, the is-

suer may rely on a statement signed by the borrower.

(5) *Time for filing.* (i) The report required by paragraph (k)(2)(i) shall be filed not later than the 15th day of the second calendar month after the close of the calendar quarter in which the obligation is issued. The statement may be filed at any time before such date but must be complete based on facts and reasonable expectations as of the date of issue. The statement need not be amended to report information learned subsequent to the date of issue or to reflect changed circumstances with respect to the issuer.

(ii) The report required by paragraph (k)(2)(ii) (relating to use of proceeds) shall be filed not later than the 15th day of the second calendar month after the close of the reporting period, except that the report for the reporting period ending September 30, 1985, is due not later than February 15, 1986. The report may be filed at any time before such date but must be complete based on facts and reasonable expectations as of the date the report is filed. The report need not be amended to reflect information learned subsequent to the date the report is filed or to reflect changed circumstances with respect to any borrower.

(iii) The Commissioner may grant an extension of time for the filing of a report required by paragraph (k)(2)(i) or (ii) if there is reasonable cause for the failure to file such report in a timely fashion.

(iv) An issue of qualified veterans' mortgage bonds issued after July 18, 1984, and prior to January 1, 1985, will be treated as satisfying the information reporting requirement of this paragraph if a Form 8038 with respect to the issue is properly filed not later than February 15, 1985; the report described in paragraph (k)(2)(ii) need not be filed with respect to such issues.

(6) *Place for filing.* The reports required by paragraph (k)(2)(i) and (ii) are to be filed at the Internal Revenue Service Center, Philadelphia, Pennsylvania 19255.

(l) *Policy statement*—(1) *In general.* (i) For obligations issued after December 31, 1984, an issue meets the requirements of this paragraph only if the applicable elected representative of the governmental unit which is the issuer (or on behalf of which the issuing authority is empowered to issue qualified mortgage bonds) has published (after a public hearing following reasonable public notice) the report described in paragraph (l)(3) by the last day of the year preceding the year in which such issue is issued and a copy of such report has been submitted to the Commissioner on or before such last day. The Commissioner may grant an extension of time for publishing and filing the report if there is reasonable cause for the failure to publish or file such report in at timely fashion. The requirements of this paragraph will be treated as met if the issuer in good faith attempted to meet the policy statement requirements of this paragraph.

(ii) With respect to reports required by paragraph (l)(1)(i) to be published and submitted to the Commissioner not later than December 31, 1984, the Commissioner has determined that there is reasonable cause for the failure to publish or file such reports in a timely fashion; such a report will be considered published and filed in a timely fashion if, not later than March 11, 1985, the report is published (after a public hearing following reasonable public notice) and a copy is submitted to the Commissioner. In addition, any report submitted not later than December 31, 1984, with respect to which an issuer in good faith attempted to satisfy the requirements of section 103A(j)(5) shall be treated as substantially satisfying the requirements of this paragraph. For example, with respect to a report submitted not later than December 31, 1984, an issuer shall not be treated as failing to satisfy the requirements of section 103A(j)(5) based on the fact that (A) the notice of public hearing failed to state the manner in which affected residents may obtain copies of the proposed report prior to the hearing, or (B) the proposed report was not available prior to or at the public hearing.

(2) *Definitions and special rules.* (i) In the case of an issuer that issues qualified mortgage bonds on behalf of one or more governmental units, a single report may be filed provided that such report is signed (A) by the applicable elected representative of each governmental unit on whose behalf obligations have been issued during any preceding calendar year or (B) by the Governor of the State in which the issuer is located.

(ii) See section 103(k)(2)(E) and the regulations thereunder for the definition of the term "applicable elected representative".

(iii) In the case of qualified mortgage bonds issued by, or on behalf of, a governmental unit that did not reasonably expect during the preceding calendar year to issue (or have issued on its behalf by any other issuer) qualified mortgage bonds during the current calendar year, the requirements of this paragraph will be treated as met if the applicable governmental unit which is the issuer (or on behalf of which the issuing authority is empowered to issue qualified mortgage bonds) has published (after a public hearing following reasonable public notice) the report described in paragraph (l)(3) prior to the issuance of any qualified mortgage bonds and a copy of such report has been submitted to the Commissioner prior to such issuance.

(iv) For purposes of this paragraph a report will be considered to be "published" when the applicable elected representative of the governmental unit has made copies of the report available for distribution to the public. Reasonable public notice of the manner in which copies of the report may be obtained must be provided; such notice may be included as part of the public notice required by paragraph (l)(4).

(3) *Report.* (i) A report is described in this paragraph (l)(3) if it contains the issuer's name, TIN, and the title "Policy Report Under Section 103A" stated on the cover page of the report and if it includes—

(A) A statement of the policies of the issuer with respect to housing, development, and low-income housing assistance which such issuer is to follow in issuing qualified mortgage bonds and mortgage credit certificates, and

(B) An assessment of the compliance of such issuer during the 1-year period preceding the date of the report with—

(1) The statement of policy on qualified mortgage bonds and mortgage credit certificates that was set forth in the previous report, if any, of the issuer, and

(2) The intent of Congress that State and local governments are expected to

use their authority to issue qualified mortgage bonds and mortgage credit certificates to the greatest extent feasible (taking into account prevailing interest rates and conditions in the housing market) to assist lower income families to afford home ownership before assisting higher income families.

(ii) For example, a report described in this paragraph (1)(3) may (but is not required to) contain—

(A) A specific statement of the policies with respect to housing, development, and low-income housing assistance which the issuer is to follow in issuing qualified mortgage bonds and mortgage credit certificates, including, for example, a statement as to—

(1) With respect to housing policies, *(i)* whether the proceeds will be used to provide financing for the acquisition of residences, to provide qualified home improvement loans, or to provide qualified rehabilitation loans; *(ii)* whether all or a portion fo the proceeds will be targeted to new, existing, or any other particular class or type of housing; *(iii)* how the existence of a need or absence of a need for such targeting has been determined; *(iv)* the method by which the proceeds will be targeted; *(v)* any other pertinent information relating to the issuer's housing policies; and *(vi)* how the housing policies relate to the issuer's development and low-income housing assistance policies;

(2) With respect to development policies, *(i)* whether all or a portion of the proceeds will be targeted to specific areas (including targeted areas as described in §6a.103A-2(b)(3)); *(ii)* a description of the areas to which the proceeds will be targeted; *(iii)* the reasons for selecting such areas; *(iv)* whether proceeds targeted to each area are to be used to finance redevelopment of existing housing or new construction; *(v)* any other pertinent information relating to the issuer's development policies; and *(vi)* how the development policies relate to the issuer's low-income housing assistance policies; and

(3) With respect to low-income housing assistance policies, *(i)* whether all or a portion of the proceeds will be targeted to low-income (*i.e.*, 80 percent of median income), moderate-income (*i.e.*, 100 percent of median income), or any other class of borrowers; *(ii)* the method by which the proceeds will be targeted to such borrowers; and *(iii)* any other pertinent information relating to the issuer's low-income housing assistance policies;

(B) An assessment of the compliance of the governmental unit or issuing authority during the twelve-month period ending with the date of the report with the statement of housing, development, and low-income housing assistance policies with respect to qualified mortgage bonds and mortgage credit certificates that were set forth in the report, if any, published in the preceding year with respect to such governmental unit, including, for example, a statement as to whether the governmental unit or issuing authority successfully implemented its policies and, if not, an analysis of the reasons for such failure; and

(C) An assessment of the compliance of the governmental unit or issuing authority during the twelve-month period ending with the date of the report with the intent of Congress that State and local governments are expected to use their authority to issue qualified mortgage bonds and mortgage credit certificates to the greatest extent feasible (taking into account prevailing interest rates and conditions in the housing market) to assist lower income families to afford home ownership before assisting higher income families, including, for example, a description of *(1)* the method used by the governmental unit or issuing authority to distribute proceeds, *(2)* whether and how that method enabled the governmental unit or issuing authority to assist lower income families before higher income families, and (3) any income levels that have been defined and used by the governmental unit or issuing authority in connection with distribution of the proceeds (no specific definition of lower income and higher income is imposed on governmental units or issuing authorities).

(iii) For purposes of the assessments of compliance required by paragraph (1)(3)(i)(B) to be included in the report, the "date of the report" means June 30. For purposes of the report required to be filed prior to January 1, 1986, an issuer need not perform these assessments of compliance with respect to any period prior to January 1, 1985.

(iv) An issuer that fails to establish policies with respect to the criteria provided in paragraph (1)(3)(i) will not be treated as failing to satisfy the requirements of this paragraph. Thus, for example, an issuer may state in its report that none of the proceeds of the issues will be targeted to specific areas. Similarly, an issuer that fails to successfully implement its policies will not be treated as failing to satisfy the requirements of this paragraph.

(4) *Public hearing.* The public hearing required by paragraph (1)(1) means a forum providing a resonable opportunity for interested individuals to expres their views, both orally and in writing, on the report that the applicable representative proposes to publish to satisfy the requirements of this paragraph (1). A public hearing held prior to January 1, 1985, will not fail to satisfy the requirements of this paragraph (1)(4) merely because the proposed policy statement was not available prior to the public hearing. In general, a governmental unit may select its own procedure for the hearing, provided that interested individuals have a reasonable opportunity to express their views. Thus, it may impose reasonable requirements on persons who wish to participate in the hearing, such as a requirement that persons desiring to speak at the hearing so request in writing at least 24 hours before the hearing or that they limit their oral remarks to 10 minutes. For purposes of this public hearing requirement, it is not necessary that the applicable elected representative who will publish the report be present at the hearing, that a report on the hearing be submitted to that official, or that State administrative procedural requirements for public hearings in general be observed. However, compliance with such State procedural requirements (except those at variance with a specific requirement set forth in this paragraph) will generally assure that the hearing satisfies the requirements of this paragraph. The hearing may be conducted by any individual appointed or employed to perform such function by the governmental unit, its agencies, or by the issuer. Thus, for example, for a report to be issued by an issuing authority that acts on behalf of a county, the hearing may be conducted by the issuing authority, the county, or an appointee or employee of either.

(5) *Reasonable public notice.* (i) The

reasonable public notice required by paragraph (1)(1) means published notice which is reasonably designed to inform residents of the geographical area within the jurisdiction of the governmental unit that will publish the report. The notice must state the time and place for the hearing and contain the information required by paragraph (1)(5)(ii). Notice is presumed reasonable if published no fewer than 14 days before the hearing. Notice is presumed reasonably designed to inform affected residents only if published in one or more newspapers of general circulation available to residents of that locality or if announced by radio or television broadcast to those residents.

(ii) The notice of hearing described in this paragraph (1)(5) must state—

(A) The time and place for the hearing,

(B) Any applicable limitations regarding participation in the hearing,

(C) With respect to any notice of hearing published after December 31, 1984, the manner in which affected residents may obtain copies of the proposed report prior to the hearing, and

(D) With respect to any notice of hearing published after December 31, 1984, that the hearing will involve the issuer's policies with respect to housing, development, and low-income housing assistance which the issuer is to follow in issuing qualified mortgage bonds and mortgage credit certificates.

(6) *Procedure for public hearings of multiple jurisdiction issuers.* In the case of an issuer that issues qualified mortgage bonds on behalf of two or more governmental units ("'multiple jurisdiction issuer"), each governmental unit on whose behalf the issuer reasonably expects to issue qualified mortgage bonds during the succeeding calendar year must hold a public hearing following reasonable public notice prior to the publication of the report required by this paragraph. A multiple jurisdiction issuer may hold a combined hearing as long as the combined hearing is a joint undertaking that provides all residents of the participating governmental units (*i.e.*, each governmental unit on whose behalf qualified mortgage bonds were issued by the authority and each governmental unit on whose behalf the authority reasonably expects to issue qualified mortgage bonds during the succeeding calendar year) a reasonable opportunity to be heard. The location of any combined hearing is presumed to provide a reasonable opportunity for all affected residents to be heard if it is no farther than 100 miles from the seat of government of each participating governmental unit beyond whose geographic jurisdiction the hearing is conducted.

(7) *Place for filing.* The report is to be filed with the Internal Revenue Service Center, Philadelphia, Pennsylvania 19255.

(m) *State certification requirements*—(1) *In general.* An issue meets the requirements of this paragraph only if the issuer in good faith attempted to meet the State certification requirements of this paragraph. The requirements of this paragraph apply to obligations issued after December 31, 1984.

(2) *Certification.* (i) An issue satisfies the requirements of section 103A(j)(4) and this paragraph (m)(2) only if the State official designated by law (or, if there is no State official, the Governor) certifies on or before the later of the date of issue or October 3, 1985, following a request for such certification by the issuer, that, as of the date the certification is executed, the issue meets the requirements of section 103A(g) and the regulations thereunder (relating to volume limitation). In the case of any constitutional home rule city, the certification shall be made by the chief executive officer of the city. To the extent consistent with State and local law, the Governor (or the chief executive officer of any constitutional home rule city) may delegate the responsibility to execute the certification required by this paragraph.

(ii) The certifying official need not perform an independent investigation in order to determine whether the issue meets the requirements of section 103A(g). In determining the aggregate amount of qualified mortgage bonds previously issued by an issuer during a calendar year, the certifying official may rely on copies of the reports submitted, to date, by the issuer pursuant to section 103A(j)(3) for other issues of qualified mortgage bonds issued during that year and copies of any elections previously made pursuant to section 25(c)(2) not to use qualified mortgage bonds, together with an affidavit executed by an officer of the issuer responsible for issuing the bonds stating that the issuer has not, to date during the calendar year, issued any other qualified mortgage bonds, the amount, if any, of the issuer's market limitation that it has, to date during the calendar year, surrendered to other issuing authorities, and that it has not, to date during the calendar year, made any other elections not to issue qualified mortgage bonds. If, based on such information, the certifying official determines that, as of the date the certification is executed, the issue will not exceed the issuer's market limitation for the year, the official may certify that the issue meets the requirements of section 103A(g).

(3) *Special rule.* If 15 days elapse after the issuer files a proper request for the certification described in paragraph (m)(2) and the issuer has not received from the State official designated by law (or, if there is no State official, the Governor) certification that the issue meets the requirements of section 103A(g) and §6a.103A-2(g) or, in the alternative, a statement that the issue does not meet such requirements, the issuer may, instead, submit an affidavit executed by an officer of the issuer responsible for issuing the bonds stating that—

(i) The issue meets the requirements of section 103(A)(g) and §6a.103A-2(g)

(ii) At least 15 days before the execution of the affidavit the issuer filed a proper request for the certification described in paragraph (m)(2), and

(iii) The State official designated by law (or, if there is no State official, the Governor) has not provided the certification described in paragraph (m)(2).

In the case of obligations issued prior to October 4, 1985 the preceding sentence shall be applied by substituting "30 days" for "15 days". For purposes of this paragraph, a request for certification is proper if the request includes the reports and affidavits described in paragraph (m)(2)(ii).

(4) *Filing.* The certification (or affidavit) required by this paragraph shall be filed with the Internal Revenue Service Center, Philadelphia, PA 19255. The certification (or affidavit) shall be submitted with the Form 8038 required to be filed by section 103A(j)

(3) and paragraph (k) of this §1.103A-2. The Commissioner may grant an extension of time for filing the certification (or affidavit) if there is a reasonable cause for the failure to file such statement in a timely fashion.

(5) *Effect of certification.* The fact that an issuer obtains the certification (or affidavit) described in this paragraph does not ensure that the requirements of paragraph (g) of this section are met. Obligations that do not meet the requirements of paragraph (g) are not described in section 103(a).

PART 6a
TEMPORARY REGULATIONS
UNDER TITLE II
OF THE OMNIBUS
RECONCILIATION ACT OF 1980

Par. 3. The authority for part 6a continues to read in part:

Authority: 26 U.S.C. 7805. * * * Section 6a.103A-2(k), (l), and (m) also issued under 26 U.S.C. 103A(j)(3), (4), and (5). * * *

Par. 4. Section 6a.103A-2 is amended by revising paragraphs (k), (l), and (m). These revised provisions read as follows:

§6a.103A-2 Qualified mortgage bond.

* * * * *

(k) *Information reporting requirement.* See §1.103A-2 (k) for rules relating to section 103A(j)(3).

(l) *Policy statement.* See §1.103A-2(l) for rules relating to section 103A(j)(5).

(m) *State certification.* See §1.103A-2(m) for rules relating to section 103A(j)(4).

PART 602
OMB CONTROL NUMBERS UNDER
THE
PAPERWORK REDUCTION ACT

Par. 4. Section 602.101(c) is amended by inserting in the appropriate places in the table "§1.103A-2 . . . . 1545-0720".

JAMES I. OWENS,
Acting Commissioner
of Internal Revenue.

Approved August 19, 1985.

RONALD A. PEARLMAN,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on August 29, 1985, 10:54 a.m., and published in the issue of the Federal Register for September 3, 1985, 50 F.R. 35540)

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26 CFR 6a.103A-2: Qualified mortgage bonds.

Listing of information pertaining to "state ceilings" as described in section 103A of the Code. See Rev. Proc. 85-39, page 443.

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26 CFR 6a.103A-2: Qualified mortgage bonds.

Listing of information pertaining to "average area purchase price" as described in section 103A of the Code. See Rev. Proc. 85-42, page 496.

Section 104.—Compensation for Injuries or Sickness

26 CFR 1.104-1: Compensation for injuries or sickness.

Damages; personal injury settlement; lost wages. The entire amount received by an individual in settlement of a suit for personal injuries sustained in an accident, including the portion of the amount allocable to the claim for lost wages, is excludable from the individual's gross income. Rev. Rul. 61-1 amplified.

Rev. Rul. 85-97

ISSUE

Are amounts received by a taxpayer, under the circumstances described below, excludable from gross income as damages received on account of personal injuries?

FACTS

The taxpayer was seriously injured when struck by a bus. To recover for the injuries suffered as a result of the negligent operation of the bus, the taxpayer sued the bus company. The complaint alleged that, as a direct and proximate result of being struck by the bus, the taxpayer had sustained serious and permanent injuries, had been unable to pursue normal employment activities and had lost wages, had suffered and would continue to suffer great pain of body and mind, had sustained permanent disability, deformity, and loss of earning capacity, and had incurred and would incur in the future hospital, doctors' and related bills in an effort to be cured of these injuries. The complaint asked for compensatory damages of 5*x* dollars. No punitive damages were quested. Prior to trial, the taxpayer the bus company agreed to a settlen under the terms of which the taxpa received a lump-sum payment of dollars in exchange for a full releas all the taxpayer's claims against the company. The taxpayer had not ducted any medical expenses in a p year.

LAW AND ANALYSIS

Section 61 of the Internal Reve Code provides, in part, that, except otherwise provided in subtitle A, gr income means all income from wh ever source derived.

Section 104(a)(2) of the Code e cludes from gross income the amou of any damages received (whether suit or agreement and whether as lu sums or as periodic payments) on a count of personal injuries or sickness

Section 1.104-1(c) of the Incon Tax Regulations provides, in part, th the term "damages received (wheth by suit or agreement)" means amount received (other than workmen compensation) through prosecution of legal suit or action based upon tort tort type rights, or through a settleme agreement entered into in lieu of su prosecution.

Rev. Rul. 61-1, 1961-1 C.B. 1 holds that the entire amount receiv by a railroad employee in settlement any and all claims that the employe had against the railroad for personal i juries is excludable from gross incor under section 104(a)(2) of the Cod even though the employee elected apportion part of the settlement amou to "time lost" in order to receive ra road retirement credit for the time t employee was unable to work. The re enue ruling states that the fact that t "time lost payments" constituted co pensation for purposes of the tax imposed by the Railroad Retireme Tax Act does not preclude the applic tion of the exclusion from gross incom under section 104(a)(2). Thus, the ru ing indicates that the exclusion pr vided by section 104(a)(2) extends personal injury damages allocable lost wages. *Also cf., Norfolk & Wes ern Ry. Co. v. Liepelt*, 444 U.S. 4 (1980) (defendant is entitled to an i struction to jury that damages for lo

future wages are not subject to federal income taxation).

In the instant case, the entire 3*x* dollars settlement amount, including the amount allocable to the claim for lost wages, represents compensation for personal injuries sustained by the taxpayer when the taxpayer was struck by the bus. Therefore, the exclusion provided by section 104(a)(2) of the Code extends to the entire settlement amount.

HOLDING

The entire 3*x* dollars settlement amount is excludable from the taxpayer's gross income under section 104(a)(2) of the Code and the regulations thereunder.

EFFECT ON OTHER REVENUE RULING

Rev. Rul. 61-1, 1961-1 C.B. 14, is amplified.

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26 CFR 1.104-1: Compensation for injuries or sickness.
(Also Sections 61, 212; 1.61-14, 1.212-1.)

Damages; libel suit settlement; compensatory and punitive. The amount received by an individual in settlement of a libel suit for injury to personal reputation is includible in the individual's gross income to the extent such amount represents the satisfaction of punitive damages. The expenses incurred by the individual that are attributable to the punitive damages are deductible by the individual. Rev. Rul. 58-418 superseded.

Rev. Rul. 85-98

ISSUES

(1) What portion of a settlement, which includes both compensatory and punitive damages, for injury to personal reputation is excludable from the recipient's gross income under the circumstances described below?

(2) Are the expenses attributable to the amounts received in settlement of the suit deductible for federal income tax purposes?

FACTS

The taxpayer was the subject of a newspaper article that contained false and defamatory statements that resulted in injury to the personal reputation of the taxpayer as an individual only and did not affect the taxpayer's business or professional reputation. Upon learning of the article, the taxpayer filed in the state court a suit for libel against the reporter who wrote the article and the corporation that published the newspaper. The complaint alleged that at all times prior to the publication of the article, the taxpayer had enjoyed a good reputation for honesty, integrity, and personal character; that as the result of the article's publication the taxpayer had suffered damage to personal reputation, social standing, and family relationships; that the article had caused the taxpayer embarrassment, shame, anxiety, and worry; and that the article had been written and published with actual intent to harm the taxpayer's personal reputation. The complaint asked for compensatory damages of 15*x* dollars and punitive damages of 45*x* dollars. The amount of compensatory damages requested relative to the amount of punitive damages requested, 1 to 3, bore a reasonable relationship to what a jury might be expected to award under the facts and circumstances of the case. Shortly before trial, the taxpayer and the defendant agreed to a settlement of the libel suit. The taxpayer received a lump-sum payment of 24*x* dollars in full settlement of all the taxpayer's claims.

In processing the case through the courts, prior to settlement, the taxpayer incurred and paid various legal expenses totaling 8*x* dollars. Under the facts and circumstances, it is reasonable to attribute these expenses on a pro-rata basis between the compensatory and punitive damages recovered. That is, the expenses allocable to the recovery of punitive damages bear the same proportion to the total expenses as the punitive damages recovered bear to the total damages received.

LAW AND ANALYSIS

Section 61 of the Internal Revenue Code provides, in part, that except as otherwise provided in subtitle A, gross income means all income from whatever source derived.

Section 1.61-14(a) of the Income Tax Regulations states, in part, that punitive damages such as treble damages under the antitrust laws and exemplary damages for fraud are gross income.

Section 104(a)(2) of the Code excludes from gross income the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness.

Section 1.104-1(c) of the regulations provides that the term "damages received (whether by suit or agreement)" means an amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution. The regulation makes no distinction between physical or emotional injuries. See *Seay v. Commissioner*, 58 T.C. 32, 40 (1972), *acq.*, 1972-2 C.B. 3. Punitive damages, however, are not excludable from gross income. See Rev. Rul. 84-108, 1984-2 C.B. 32.

In Rev. Rul. 58-418, 1958-2 C.B. 18, a taxpayer received an amount in settlement of a libel suit in which the taxpayer had asked for both compensatory and punitive damages. Because of the lack of adjudication, the amount was not distinguished as to the portions allocable to satisfaction of the taxpayer's claim for compensatory damages as distinguished from the taxpayer's claim for punitive damages. The revenue ruling concludes that, inasmuch as the tax consequences attributable to each claim differ, allocation is necessary and proper and that the best evidence available under the facts and circumstances of the case to determine a proper allocation is the taxpayer's complaint.

In Rev. Rul. 75-230, 1975-1 C.B. 93, a taxpayer received an amount in settlement of a personal injury suit. In determining what part of the settlement amount was allocable to medical expenses incurred and deducted under section 213 of the Code in a prior year, the revenue ruling states that Rev. Rul. 58-418 provides a method of allocation, with respect to settlement of a libel suit, that is based on the best evidence available under the circumstances, which, in Rev. Rul. 58-418, was the relative percentages of the amounts alleged in the complaint. Rev. Rul. 75-230 distinguishes Rev. Rul. 58-418 based on a conclusion that the best evidence available on which to base an allocation under the facts and

circumstances of Rev. Rul. 75-230 is the amount of previously paid medical expenses, which is a sum certain, in contrast with the generally speculative nature of the pain and suffering damages alleged in a personal injury suit.

In this case, the best evidence available to determine a proper allocation is the taxpayer's complaint, since the amount of punitive damages relative to compensatory damages requested bore a reasonable relationship to what a jury might be expected to award. The taxpayer received a lump-sum settlement amount of 24*x* dollars. The taxpayer's complaint, however, asked for compensatory damages of 15*x* dollars and punitive damages of 45*x* dollars. Thus, the amount of compensatory damages asked equaled 25 percent and the amount of punitive damages asked equaled 75 percent of the total 60*x* dollars damages asked.

Section 212 of the Code allows a deduction, in the case of an individual, for all the ordinary and necessary expenses paid or incurred during the taxable year for the production of income.

HOLDINGS

(1) Inasmuch as the taxpayer's complaint is the best evidence available to determine a proper allocation under the facts and circumstances of the instant case, 25 percent of the 24*x* dollars settlement amount, 6*x* dollars, is considered to be in satisfaction of compensatory damages and is excludable from the taxpayer's gross income under section 104(a)(2) of the Code and the regulations thereunder. The remaining 75 percent, 18*x* dollars, is considered to be in satisfaction of punitive damages and is includable in the taxpayer's gross income under section 61 and the regulations thereunder.

(2) The expenses incurred and paid to procure the portion of the settlement that is includible in gross income are deductible under section 212 of the Code as ordinary and necessary expenses paid or incurred by an individual for the production or collection of income. Because the expenses are to be allocated between the compensatory and punitive damages on a pro-rata basis, 75 percent of the total 8*x* dollars expense of procuring the settlement, 6*x* dollars, is deductible under section 212 of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 58-418 is superseded.

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26 CFR 1.104-1: Compensation for injuries or sickness.

Disability benefits; police officers and fire fighters; District of Columbia. The extent to which payments received by disabled police officers and fire fighters under sections 4-615 and 4-616 of the District of Columbia Code are excludable from gross income under section 104(a)(1) of the Code is set forth. Rev. Rul. 79-147 superseded.

Rev. Rul. 85-104

ISSUE

Are payments received by disabled police officers and fire fighters under sections 4-615 and 4-616 of the District of Columbia Code excludable from gross income under section 104(a)(1) of the Internal Revenue Code?

FACTS

The District of Columbia Code (D.C. Code), sections 4-615 and 4-616 (1981), provide disability retirement benefits to certain police officers and fire fighters. Persons eligible to receive disability retirement benefits under sections 4-615 and 4-616 are officers and members of the Metropolitan Police force, the Fire Department of the District of Columbia, the United States Park Police force, the Executive Protective Service, and certain officers or members of the United States Secret Service Division. Pursuant to section 4-612, these employees contribute a percentage of their salary to a retirement fund (which also contains employer contributions), from which the disability retirement benefits are paid.

Section 4-615 of the D.C. Code provides an annuity to police officers and fire fighters who are disabled due to an injury or disease incurred other than in the performance of duty.

Section 4-616(a) of the D.C. Code provides an annuity to police officers and fire fighters who are injured or contract a disease in the performance of duty or who receive an aggravation of such injury or disease in the performance of duty, and such injury, disease, or aggravation permanently disables the police officer or fire fighter for the p formance of duty. The annuity is eq to the greater of (a) 66 2/3 percent the individual's average pay, or (b) 1/2 percent of the individual's avera pay multiplied by the number of full partial years of service. However, t annuity shall not exceed 70 percent the individual's average pay.

Section 4-616(e) of the D.C. Co provides an annuity to officers a members of the Metropolitan Poli force and the Fire Department of t District of Columbia who first becan officers and members after the 90-d period beginning on the date of the e actment of the District of Columbia R tirement Reform Act and who are i jured or contract a disease in t performance of duty or who receive aggravation of such injury or disease the performance of duty and such i jury, disease, or aggravation perm nently disables the police officer or fi fighter from the performance of dut The annuity is the greater of (a) 40 pe cent of the individual's basic salary the time of his or her retirement, (b) 70 percent of the individual's bas salary at the time of his or her retir ment multiplied by the percentage disability incurred. Under sectio 4-616(e)(2)(B), the percentage of dis bility is determined with reference t the following factors: (i) the nature the injury or disease; (ii) the percentag of impairment as determined by th Board of Police and Fire Surgeons (iii) the position held by the membe immediately prior to retirement; (iv) the age and years of service of th member; (v) and any other factors circumstances which may affect the ca pacity of the member to earn wages engage in gainful activity in a disable condition.

Section 4-616(b) of the D.C. Cod provides an annuity to officers an members of the United State Park Po lice force, the Executive Protectio Service, and the United States Secre Service Division who incur an on-the job aggravation of an injury or disease not incurred in the performance of dut or for which the proximate cause i doubtful, rendering the individual per manently disabled for the performanc of duty. The annuity is equal to th greater of (a) 66 2/3 percent of the in dividual's average pay or (b) 2 1/2 per

cent of the individual's average pay multiplied by the number of full or partial years of service. However, the annuity shall not exceed 70 percent of the individual's average pay.

LAW AND ANALYSIS

Section 104(a)(1) of the Code provides, with certain exceptions not pertinent here, that gross income does not include amounts received under workmen's compensation acts as compensation for personal injuries or sickness.

Section 1.104-1(b) of the Income Tax Regulations states that section 104(a)(1) of the Code excludes from gross income amounts that are received by an employee under a workmen's compensation act or under a statute in the nature of a workmen's compensation act that provides compensation to employees for personal injuries or sickness incurred in the course of employment. However, section 104(a)(1) does not apply to a retirement pension or annuity to the extent that it is determined by reference to the employee's age, length of service, or prior contributions, even though the employee's retirement is occasioned by an occupational injury or sickness. Section 104(a)(1) also does not apply to amounts that are received as compensation for a nonoccupational injury or sickness or to amounts received as compensation for an occupational injury or sickness to the extent that they are in excess of the amount provided in the applicable workmen's compensation act or acts.

If disability benefits are received under a workmen's compensation act, or under a statute in the nature of a workmen's compensation act, they qualify for the section 104(a)(1) exclusion. A statute is in the nature of a workmen's compensation act if it provides compensation to employees only for personal injuries or sickness incurred in the course of employment. Thus, if disability retirement benefits are paid pursuant to such a statute, those benefits will qualify for the section 104(a)(1) exclusion. *See* Rev. Rul. 80-14, 1980-1 C.B. 33. If benefits are computed by a formula that does not refer to the employee's age, length of service, or prior contributions and are provided to a class that is restricted to employees with service-incurred injuries, then the benefits are payments for those injuries, and the statute under which the benefits are paid qualifies as a statute in the nature of a workmen's compensation act. *See* Rev. Rul. 80-84, 1980-1 C.B. 35.

The fact that the amount received is equal to the employee's salary at the date of the disability or is based on a percentage of that salary does not disqualify the payment from qualifying as one in the nature of workmen's compensation. *See* Rev. Rul. 68-10, 1968-1 C.B. 50. Nor does the fact that employees contribute a percentage of their salary to a retirement fund, pursuant to section 4-612, disqualify the payments since the amount of the disability pensions does not depend on the amount so contributed.

The benefits provided by section 4-615 of the D.C. Code are amounts received as compensation for a nonoccupational injury or sickness. Accordingly, that section of the D.C. Code is not a statute in the nature of a workmen's compensation act within the meaning of section 1.104-1(b) of the regulations. *See* Rev. Rul. 79-147, 1979-1 C.B. 80, which holds that section 4-526 (the predecessor of section 4-615) of the D.C. Code is not a statute in the nature of a workmen's compensation act within the meaning of section 1.104-1(b) of the regulations.

The benefits provided by sections 4-616(a), 4-616(b), and 4-616(e) of the D.C. Code are authorized by a statute that restricts benefits to a class of employees with service-incurred injuries or diseases resulting in permanent disabilities. The benefits provided by section 4-616(b), for a service-related aggravation of an existing injury or illness are received under a statute in the nature of a workmen's compensation act since the increment or increase in the injury or illness caused by the job-incurred aggravation is in itself in the nature of an injury or illness.

However, the benefits provided under sections 4-616(a) and 4-616(b) of the D.C. Code are partially computed by reference to the employee's length of service. To the extent that an annuity provided under sections 4-616(a) and 4-616(b) exceeds 66 2/3 percent of the employee's salary, it is attributable to the employee's length of service. Therefore, although sections 4-616(a) and 4-616(b) are statutes in the nature of a workmen's compensation act, annuities provided to employees under sections 4-616(a) and 4-616(b) are excluded from gross income under section 104(a)(1) of the Code only to the extent they do not exceed 66 2/3 percent of the employee's average pay. The benefits provided under section 4-616(e) are computed under a formula that refers to the employee's basic salary and percentage of disability. While age and years of service are mentioned in this formula, they are only considered as factors in determining the percentage of disability, not in directly calculating the annuity. Accordingly, section 4-616(e) is a statute in the nature of workmen's compensation act within the meaning of section 1.104-1(b) of the regulations.

HOLDING

Payments received by disabled police officers and fire fighters under section 4-615 of the D.C. Code are not excludable under section 104(a)(1) of the Code. The total annuity received by an employee pursuant to section 4-616(e) is excludable from gross income under section 104(a)(1). An annuity provided to an employee under section 4-616(a) or 4-616(b) is excludable under section 104(a)(1) only to the extent it does not exceed 66 2/3 percent of the employee's average pay.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 79-147 is superseded.

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26 CFR 1.104-1: Compensation for injuries or sickness.
(Also Section 61; 1.61-2.)

Disability benefits; fire fighter; presumption of service connection. A pension received by a disabled fire fighter under a state statute that creates a rebuttable presumption the disability was service connected is excludable from gross income to the extent the pension is not attributable to length of service.

Rev. Rul. 85-105

ISSUE

Are payments made to a retired firefighter excludable from gross income under section 104(a)(1) of the In-

ternal Revenue Code under the circumstances described below?

FACTS

A, a municipal fire fighter, developed dizziness and chest pains while fighting a fire on August 1, 1984. Shortly after, *A*'s doctor stated that *A* was suffering from heat stroke and exhaustion. On December 1, 1984, *A* suffered a heart attack while at home. *A* had no history of prior heart disease. After examination by the proper medical authorities, *A* retired with 26 years of service and received a service-connected disability pension pursuant to section 2 of the state, *ST*, statutes.

Section 1 of the *ST* statutes provides that any person who is a member of a regularly constituted fire department of any city or town within *ST* who serves as a member for not less than 20 years, the last 5 years continuously in the fire department in which that person was a member when retired, is entitled upon written request to retire from service. Upon retirement, the member will be paid a monthly pension of 50 percent of the fire fighter's average monthly salary paid for service in the fire department during the last 30 months of service. In addition, for each year of service beyond 20 years, but not to exceed 10 years, the firefighter is entitled to receive an additional 2 1/2 percent of the average monthly salary that was paid for services in the fire department during the last 30 months of service. In no event shall the member be entitled to receive more than 75 percent of salary.

Section 2 of the *ST* provides that any person serving in any capacity in a regularly constituted fire department of a city or town within *ST* may be retired whenever that person becomes physically or mentally disabled in the course of his or her duties and the disability prevents the effective performance of such duties. If retired, the Board of Trustees of the Firemen's Relief and Pension Fund will direct that the disabled fire fighter be paid from the fund a monthly pension of 50 percent of the average salary that was paid during the last 30 months of service or, if greater, the pension calculated on the regular retirement formula as set forth in section 1 of the *ST* statutes. Section 2 of the *ST* statutes further provides that the larger sum will be paid as a disability pension because *ST*'s intention and public policy is that disabled fire fighters should draw as disability pension the greater amount determined under the formula of section 1 or 2 of the *ST* statutes.

Section 3 of the *ST* statutes provides that any member of the fire department of any city or town within *ST* who is disabled as the result of heart disease or injury to the respiratory system, which disease or injury was not revealed by the physical examination passed by the member upon entry into the department, is presumed to have incurred the disease or injury while performing official duties as a member of the department unless the contrary is shown by competent evidence. Any such member who applies for disability benefits as a result of heart disease or injury to the respiratory system not revealed by the physical examination passed by the member upon entry into the department must be examined by three physicians, each of whom must submit a written report of findings to the board.

Under section 1 of the *ST* statutes, *A* was entitled to receive 65 percent of *A*'s average monthly salary paid during the last 30 months of *A*'s service; under section 2, *A* was entitled to receive 50 percent. Therefore, under the provisions of section 2, *A* was awarded a pension of 65 percent of *A*'s monthly salary paid during the last 30 months of service.

LAW AND ANALYSIS

Section 61(a) of the Code provides that, except as otherwise provided by law, gross income means all income from whatever source derived, including compensation for services.

Section 104(a)(1) of the Code provides, with certain exceptions not pertinent here, that gross income does not include amounts received under workmen's compensation acts as compensation for personal injuries or sickness.

Section 1.104-1(b) of the Income Tax Regulations provides that section 104(a)(1) of the Code excludes from gross income amounts received by an employee under a workmen's compensation act or under a statute in the nature of a workmen's compensation act that provides compensation to the employee for personal injuries or sickness incurred in the course of employme
However, the exclusion under secti
104(a)(1) does not apply to a retireme
pension or annuity to the extent that
is determined by reference to the e
ployee's age or length of service, or t
employee's prior contributions, ev
though the employee's retirement is c
casioned by an occupational injury
sickness.

Rev. Rul. 80-14, 1980-1 C.B. 3
and Rev. Rul. 80-44, 1980-1 C.B. 3
hold that statutes providing benefits
a class restricted to employees wi
service-incurred disabilities are statut
in the nature of workmen's compens
tion. In both revenue rulings, a medic
examination was necessary to certi
the employee's work-related disabilit

In *Take v. Commissioner*, 82 T.C
630 (1984), a state occupational dis
bility statute was held not to be a sta
ute in the nature of a workmen's com
pensation act because it created a
irrebuttable presumption that certai
disabilities were occupationally-relate

Under the *ST* statutes, a rebuttabl
presumption is created in favor of
finding of service-incurred disability
The statutory presumption does not re
move the necessity to demonstrate tha
the disability is work-related. It merel
shifts the burden of proof concernin
the cause of disability to the board o
the pension fund. The board still mus
make a finding, based on medical evi
dence, whether the employee's disabil
ity was service-connected. Therefore
the lifetime benefits received by *A* ar
authorized by a statute that provide
benefits to a class restricted to employ
ees with service-incurred disabilities
Because these benefits are payable fo
those disabilities, *ST*'s statute is a stat
ute in the nature of a workmen's com
pensation act.

The pension received by *A* under the
service-connected disability retiremen
provisions of *ST*'s statutes is excludable
from *A*'s gross income under section
104(a)(1) of the Code to the extent tha
the pension does not exceed 50 percen
of *A*'s final salary over the last 30
months of service. The excess (the ex-
tra 15 percent that, pursuant to section
2 of the *ST* statutes, is received under
section 1 of the *ST* statutes) is attributa-
ble to length of service and is not ex-
cludable under section 104(a)(1). Rev.
Rul. 80-44.

HOLDING

A may exclude, under section 104(a)(1) of the Code, a monthly pension equal to 50 percent of the average monthly salary paid to *A* during the last 30 months of *A*'s service. The excess is not excludable from gross income under section 104(a)(1).

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26 CFR 1.104-1: Compensation for injuries or sickness.

Damages; libel suit. The Service will not follow the opinion of the United States Court of Appeals in *Roemer v. Commissioner,* 716 F.2d 693 (9th Cir. 1983), *rev'g* 79 T.C. 398 (1982), relating to the taxability of compensatory damages awarded in a libel suit. The Service will follow the decision of the Tax Court in *Roemer.*

Rev. Rul. 85-143

The Internal Revenue Service will not follow the opinion of the United States Court of Appeals in *Roemer v. Commissioner,* 716 F.2d 693 (9th Cir. 1983), *rev'g* 79 T.C. 398 (1982). The Service will follow the decisions of the Tax Court in *Roemer.*

In *Roemer,* the taxpayer was an insurance broker who had operated his own insurance business in California for many years. By the mid-1960's, the taxpayer enjoyed an excellent reputation in the community, both personally and professionally, and earned a high income from his insurance business. Until 1965, the taxpayer sold primarily casualty insurance. At that time, the taxpayer had an opportunity to expand into the life insurance business. In connection with that opportunity, the taxpayer applied for an agency license from *IC,* a life insurance company. *IC* ordered a credit report on the taxpayer from *X,* a credit bureau. *X* prepared the credit report and sent copies to *IC* and other insurance companies.

X's report on the taxpayer was grossly defamatory. It falsely stated that the taxpayer was ignorant in insurance matters, neglected his clients' affairs, was recently fired from his position as president of an insurance firm, and intentionally defaced property belonging to others. The report also implied that the taxpayer had misappropriated funds belonging to others for his personal benefit.

Upon learning of the report, the taxpayer demanded that *X* issue a retraction. *X* then distributed a purported retraction to those companies that had received the original report. The purported retraction contained further false and defamatory innuendos concerning the taxpayer's fitness as an insurance agent and his general business and personal character.

As a result of *X*'s report, *IC* and other insurance companies denied the taxpayer agency licenses to sell life insurance. The taxpayer's existing business relationships were damaged, as well as his ability to attract new clients due, in part, to the fact that most of his friends were also his clients, and vice versa. *X*'s report thus caused the taxpayer's insurance profits to diminish, and damaged his business reputation.

The taxpayer filed an action for libel under section 45 of the California Civil Code, West's Ann. Cal. Civ. Code §45, which provides as follows:

> Libel is a false and unprivileged publication by writing, printing, picture, effigy, or other fixed representation to the eye, which exposes any person to hatred, contempt, ridicule, or obloquy, or which causes him to be shunned or avoided, or which has a tendency to injure him in his occupation.

The taxpayer's complaint claimed that *X*'s report damaged his good reputation as a licensed insurance broker, causing him to lose insurance business and profits. He subsequently filed an amended complaint, alleging that publication of the report was done "with intent to damage his reputation, and to injure him in his business profession and occupation." Both compensatory and punitive damages were sought in the amended complaint.

At trial, the taxpayer produced substantial evidence concerning how the defamatory credit report adversely affected his insurance business, causing him to lose income. While the taxpayer described in detail to the jury how the defamatory report affected his business relations, he said little, if anything, about how the report affected his personal affairs.

The taxpayer's counsel, in addressing the jury on the amount of damages to which the taxpayer was entitled, asserted that the defamatory report injured both the taxpayer's personal and professional reputation. Counsel argued that the defamatory report caused severe damage to the taxpayer's general reputation and caused mental distress.

The judge instructed the jury that it could consider the injuries to both the taxpayer's personal and professional reputation in reaching a verdict. The jury awarded the taxpayer both compensatory and punitive damages, but gave no indication of the basis upon which it arrived at the verdict. The jury verdict was upheld on appeal in *Roemer v. Retail Credit Co.,* 44 Cal. App. 3d 926, 119 Cal. Rptr. 82 (1975).

This revenue ruling deals only with the compensatory damages. With respect to the taxability of the punitive damages, see Rev. Rul. 84-108, 1984-2 C.B. 32.

Section 104(a)(2) of the Code provides, with an exception not relevant here, that gross income does not include the amount of any damages received (whether by suit or agreement and whether as lump-sums or as periodic payments) on account of personal injuries or sickness.

The issue in the Tax Court in *Roemer* was whether the award in the libel suit was includible in the taxpayer's gross income for 1975. The taxpayer argued that if there is an inextricable combination of damages to both professional and personal reputation, the entire award is excludable from gross income under section 104(a)(2) of the Code. However, the court, at pages 405-406 stated:

> We think the taxation of damages received pursuant to a court judgment in a suit for injury to a person's reputation, caused by defamatory statements constituting libel, depends on whether or not such defamation results in injury to the personal reputation of an individual, as distinguished from libel that injures his business or professional reputation, to the extent it has affected or may affect his income.

The court stated that, in view of this principle, the taxpayer was required to provide that the damages resulted from injury to his personal reputation.

The Tax Court, in ascertaining the nature of the damages received by the taxpayer, examined the allegations contained in his first and amended complaints filed in the state libel suit and the issues and evidence before the state court. Based on these factors, the court concluded that the predominant nature of the taxpayer's claims involved dam-

age to his business and professional reputation as an insurance broker. Therefore, the Tax Court held that the compensatory damages that the taxpayer received as a result of the libel action were includible in his gross income.

The Tax Court later distinguished its decision in *Roemer* in *Church v. Commissioner*, 80 T.C. 1104 (1983). The petitioner in *Church* was the elected state attorney general of Arizona. In response to one of the petitioner's speeches, a local newspaper published a front-page editorial tying petitioner to communism. The petitioner filed a complaint for libel in state court against the newspaper. The jury awarded petitioner compensatory and punitive damages, but gave no indication of the basis upon which it arrived at the award.

In *Church*, the Tax Court held that the compensatory damages were excludable from petitioner's gross income under section 104(a)(2) of the Code. Upon review of the pleadings, the evidence, and the arguments made at the state trial, the court found that the entire thrust of the petitioner's case was how the libelous editorial affected the petitioner personally. The court in *Church* distinguished *Roemer* on the basis that in *Church*, unlike *Roemer*, the jury "simply did not intend to compensate the petitioner for injury to his professional or business reputation to the extent it affected past or future income."

The court of appeals subsequently reversed the Tax Court's decision in *Roemer*, holding that the compensatory damages were not includible in the taxpayer's gross income. The court of appeals stated that the Tax Court's opinion illogically distinguished physical from nonphysical personal injuries and confused a personal injury with its consequences.

The court of appeals noted that when an individual recovers damages for a physical personal injury, the lump-sum award is not allocated between the personal aspects of the injury and the economic loss resulting from the personal injury, nor is the exclusion of section 104(a)(2) of the Code unavailable when the predominant result of the injury is loss of income. The court of appeals concluded that the rule for physical personal injuries should apply to nonphysical personal injuries, stating that the relevant distinction should be between personal and nonpersonal injuries, not between physical and nonphysical injuries.

To determine whether the damages awarded to the taxpayer were for personal injuries, the court of appeals analyzed the nature of the tort of defamation under California law. It pointed out that California defamation statutes (including section 45 of the Civil Code under which the taxpayer had originally brought his action before the state court) appear in the Civil Code at "Division 1. Persons. Part 2. Personal Rights." In contrast, the court of appeals noted, California law also provides for the related tort of disparagement or trade libel that remedies an attack on the quality of the plaintiff's products or services.

While noting that the same statement may give rise to both defamation and disparagement actions, the court of appeals observed that defamation concerns the person of the plaintiff, while disparagement concerns the plaintiff's goods. The court of appeals pointed out that the injury to the person caused by the defamation should not be confused with the derivative consequences of the defamatory attack, such as the loss of reputation in the community and any resulting loss of income. It stated that while a defamatory statement may impair both the personal and professional relationships of the victim, all of the harm flows from the same personal attack.

The court of appeals found that the taxpayer suffered damage to both his personal and professional relationships as a result of the false report filed by *X*. It held that the compensatory damages received by the taxpayer in the defamation suit are excludable from his gross income under section 104(a)(2) of the Code, as would be the compensatory damages received on account of any personal injury, since defamation of an individual is a personal injury under California law.

The Service continues to believe the decision of the Tax Court is correct. Whether a libel in a particular situation is a personal injury should depend on the nature of the libel. In factual situations similar to *Roemer*, where the libelous statements were directed primarily to the individual in the individu business capacity, with the result the primary harm suffered by the i vidual was loss of business income, individual has not suffered a pers injury for purposes of section 104(a of the Code. The characterization of lawsuit brought by the individual un the law of the particular state wh suit was filed should not determine characterization of the damages ceived for federal income tax purpos

It is true that where a taxpayer s fers a physical personal injury, all co pensatory damages received theref are excludable from gross income u der section 104(a)(2) of the Code, cluding any damages received to co pensate the taxpayer for income lo while the taxpayer was disabled by t injury. See Rev. Rul. 85-97, pag 50, this Bulletin. Although damag may be measured, at least in part, the amount of lost income, they neve theless are attributable to a personal i jury, as required by the statute. In t present case, however, the Tax Cou found that the taxpayer's claims f which the state court awarded him a r covery were predominantly for inju to his business and professional reput tion as an insurance broker, and th the main thrust of the evidence he pr sented to the jury was of lost busine income. 79 T.C. at 406. If a taxpay operates a business, whether as a pr prietorship or a corporation, a defam tory statement that is directed at th business and causes loss of business i come is an injury to the business as di tinguished from a personal injury. T the extent damages received by the ta payer are for an injury to the taxpayer business, they are not attributable to personal injury and are not excludab under section 104(a)(2).

Section 105.—Amounts Received Under Accident and Health Plans

26 CFR 1.105-1: Amounts attributable to e ployer contributions.

For the purpose of section 105 of the Code laid-off worker is an "employee" during the riod of layoff. See Rev. Rul. 85-121, page 5

Section 106.—Contributions by Employer to Accident and Health Pla

26 CFR 1.106-1: Contributions by employer accident and health plans.

(Also Sections 105, 3401; 1.105-1, 31.3401 (a)-1.)

Insurance; premiums paid by employer; accident and health plan; laid-off worker. A laid-off worker is an "employee" during the period of layoff for purposes of an accident or health plan described in sections 105 and 106 of the Code.

Rev. Rul. 85-121

ISSUE

Under the circumstances described below, is a laid-off worker an "employee" during the period of layoff for purposes of an accident or health plan described in sections 105 and 106 of the Internal Revenue Code?

FACTS

Corporation *X* maintains for its employees an employer-financed accident and health plan that qualifies as an accident or health plan described in sections 105(e) and 106 of the Code. Pursuant to the collective bargaining agreement between *X* and its employees, the plan also provides identical accident and health coverage for former active employees of *X* who have been laid off during the term of the agreement and who are available for work.

A, an employee, was laid off by *X* for a period of time. During the period of layoff *X* made contributions to its accident and health plan on behalf of *A*, and *A* received health benefit payments from the plan.

LAW AND ANALYSIS

Section 106 of the Code provides that gross income of an employee does not include contributions by the employer to an accident or health plan for compensation (through insurance or otherwise) to the employees for personal injuries or sickness.

Section 106 of the Code operates in conjunction with section 105, which provides, with certain exceptions, that amounts an employee receives through accident or health insurance for personal injuries or sickness are includible in gross income to the extent the amounts (1) are attributable to contributions by the employer that were not includible in the gross income of the employee, or (2) are paid by the employer. Withholding is required on payments of amounts includible in gross income under section 105(a) pursuant to section 3401(a) and section 31.3401(a)-1(b)(8) of the Employment Tax Regulations.

Rev. Rul. 82-196, 1982-2 C.B. 53, holds, in part, that employer contributions to an accident or health plan that provides coverage for an employee and the employee's spouse and dependents before and after the employee's retirement and for a deceased employee's surviving spouse and dependents are excludable from the gross income of the employee and the survivors under section 106 of the Code. Rev. Rul. 82-196 also holds that the taxation of health benefits paid to survivors of a deceased employee-participant in such a plan is determined under section 105. The revenue ruling in effect considers an employee-participant in an employer-funded accident or health plan to continue to be an "employee" for purposes of section 105 and 106 even after termination of employment.

As in the case of retired or deceased employees, *X*'s contributions to the accident and health plan on behalf of *A* were based solely upon the employment relationship. *A*'s treatment under section 105 and 106 should, therefore, be the same as that of the retired or deceased employees in Rev. Rul. 82-196.

HOLDING

During the period of layoff, the laid-off worker is an "employee" for purposes of sections 105 and 106 of the Code.

Section 107.—Rental Value of Parsonages

26 CFR 1.107-1: Rental value of parsonages.

Whether a minister may deduct interest and taxes paid on a personal residence if the amounts expended are allocable to a rental allowance that is otherwise excludable from gross income under a particular section of the Code. See Rev. Rul. 85-96, page 87.

Section 108.—Income From Discharge Of Indebtedness

26 CFR 1.108(a)-1: Income from discharge of indebtedness.

Conditions under which the Service will issue an advance ruling and enter into a closing agreement permitting a variation from the general rule of section 1.1017-1 of the regulations relating to the adjustment to basis of depreciable property resulting from a discharge of indebtedness under section 108 of the Code. See Rev. Proc. 85-44, page 504.

Section 111.—Recovery Of Tax Benefit Items

26 CFR 1.111-1: Recovery of certain items previously deducted or credited.

Research or experimental costs previously deducted pursuant to section 174(a) of the Code are not subject to recapture upon the subsequent sale of the resulting technology. See Rev. Rul. 85-186, page 84.

Section 117.—Scholarships and Fellowship Grants

26 CFR 1.117-1: Exclusion of amounts received as a scholarship or fellowship grant.

Clarification of Rev. Proc. 76-47, 1976-2 C.B. 670, which provides guidelines to be used in determining whether educational grants made by a private foundation under an employer-related grant program qualify as scholarships or fellowship grants. See Rev. Proc. 85-51, page 717.

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26 CFR 1.117-5: Federal grants requiring future service as a federal employee.

T.D. 8032

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1983; PART 602—REPORTING AND RECORDKEEPING REQUIREMENTS

Federal Grants Not Includible in Income in Certain Cases

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to certain federal grants and scholarships which are not includible in income. Changes to the applicable law made by the Tax Treatment Act of 1980 [Pub. L. 96-541, 1980-2 C.B. 596] are reflected in this document. These regulations provide guidance to Internal Revenue Service personnel who administer the Code and members of the public who are subject to these laws.

DATES: These regulations are effective for amounts received under qualifying programs after December 31, 1980.

FOR FURTHER INFORMATION CONTACT: Margaret M. O'Connor of

the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. (Attention: CC:LR:T, 202-566-3287, not a toll free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On August 22, 1984, the FEDERAL REGISTER published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 117(c) of the Internal Revenue Code of 1954 (49 FR 33281) [LR-72-81, 1984-2 C.B. 849]. No comments were received. A public hearing was not requested. Accordingly, the proposed amendments are adopted by this Treasury decision as they appeared in the FEDERAL REGISTER. Typographical errors which were contained in the notice of proposed rulemaking have been corrected.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although a notice of proposed rulemaking which solicited public comments was issued, the Internal Revenue Service concluded when the notice was issued, that the regulations are interpretative and that the notice and public procedure requirement of 5 U.S.C. 553 did not apply. Accordingly, the final regulations do not constitute regulations subject to the Regulatory Flexibility Act of (5 U.S.C. chapter 6).

The collection of information contained in these regulations has been submitted to the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these regulations is Margaret M. O'Connor of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations.

Accordingly, 26 CFR Part 1 is amended by adopting, without change, the regulations proposed as a notice of proposed rulemaking published in the FEDERAL REGISTER on August 22, 1984, (49 FR 33281) [LR-72-81, 1984-2 C.B. 849] and Part 602 is amended as follows:

Paragraph 1. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805. * * *

Par.2. Paragraph (b) of §1.117-3 is amended by removing "institution" wherever it appears and inserting in lieu thereof, "organization" and by removing "section 117 adopts" wherever it appears and inserting in lieu thereof "parragraphs (a) and (b) of §117 adopt".

Par. 3. The first sentence of paragraph (c)(1) of §1.117-4 is amended by inserting the phrase "and §1.117-5" after "§1.172-2".

Par. 4. A new §1.117-5 is added to read as set forth below.

§1.117-5. Federal grants requiring future service as a federal employee.

(a) *In general.* Under section 117(c), amounts received by an individual under a federal program as a scholarship or grant for qualified tuition and expenses at an institution of higher education are excluded from the gross income of the recipient even though the recipient is required to perform future service as a federal employee. See paragraph (c) of this section for the definition of the terms "qualified tuition and expenses" and "institution of higher education."

(b) *Exception for uniformed services scholorship programs.* The requirements of this section do not apply to amounts received before 1985 by a member of a uniformed service who entered training before 1981 under the Armed Forces Health Professions Scholarship Program. National Public Health Service Corps Scholarship Training Program, or other substantially similar federal programs requiring the recipient to work for a uniformed federal service after completion of studies. These awards are governed by section 4 of Pub. L. 93-483 as amended by Pub. L. 95-171, Pub. L. 95-600 and Pub. L. 96-167. See section 101(3) of title 37, United States Code for the definition of the term "uniformed service."

(c) *Definitions.* (1) *Qualified tuition and related expenses.* For purposes of section 117(c) and this section, qualified tuition and related expenses are those amounts which under the terms of the federal program are required to be used and in fact are used for payment of:

(i) Tuition and fees that are required for the recipient's enrollment or attendance at an institution of higher education; and

(ii) Those amounts used for payment of fees, books, supplies and equipment required for courses of instruction at such an institution.

Incidental expenses are not considered related expenses and thus are not excludable from gross income under section 117(c). Incidental expenses include room and board at an institution of higher education, expenses for travel (including expenses for meals and lodging incurred during travel and allowances for travel of the recipient's family), research, clerical help, equipment and other expenses which are not required for enrollment at the institution or in a course of instruction at such institution.

(2) *Institution of higher education.* To qualify as an institution of higher education under this section, the institution must be a public or other nonprofit institution in any state which—

(i) Admits as regular students only individuals who have a certificate of graduation from a high school or the recognized equivalent of such a certificate;

(ii) Is legally authorized within the state to provide a program of education beyond high school; and

(iii) provides an educational program for which it awards a bachelor's or higher degree or which is acceptable for full credit towards such a degree, or which trains and prepares students for gainful employment in a recognized health profession. For purposes of this section, recognized health professions are thoe health professions which are supervised or monitored by appropriate state or federal agencies or governing professional associations and which require members to be currently licensed or certified in order to practice.

(3) *Service as a federal employee*—(i) *In general.* Except as otherwise provided in paragraph (c)(3)(ii) of this section, service as a federal employee refers to employment of the recipient by the federal government to work directly for the federal government. Thus, federal grants or scholarships which do not require the recipient to work directly for the federal government are not governed by the rules of this section.

(ii) *Service in a health manpower shortage area.* For purposes of this section an obligation under a grant for the recipient to serve in a health related field in a health manpower shortage area as designated by the Secretary of Health and Human Services according to the criteria of the Public Health Services Act (42 U.S.C. 254(e)) and the regulations promulgated thereunder (42 CFR 5.1-5.4) will be considered an obligation to serve as a federal employee.

(d) *Records required for exclusion from gross income.* To exclude amounts received under federal programs requiring future services as a federal employee, the recipient must maintain records that establish that the amounts received under such programs were used for qualified tuition and related expenses as defined in paragraph (c)(91) of this section. Qualifying uses may be established by providing to the Service, upon request, copies of relevant bills, receipts, cancelled checks or other convenient documentation or records which clearly reflect the use of the money received under the grant. The recipient must also submit, upon request, documentation establishing receipt of the grant and setting out the terms and requirements of the particular grant.

(e) *Applicability of rules of §§117(a) and 117(b).* Except where a different rule has been expressly provided in this section, amounts received under federal grants requiring future service as a federal employee, and which meet the requirements for exclusion from gross income under this section, are subject to the rules, limitations and definitions specified in §§117(a) and (b) of the Code and §§1.117-1 through 1.117-4.

(f) *Effective date.* Except as provided in paragraph (b) of this section, this section will apply to amounts received after December 31, 1980 under federal programs which meet the requirements of this section.

Par. 5. The authority citation for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 6. Section 602.101(c) is amended by inserting in the appropriate places in the table: "§1.117-5. . . 1545-0869".

[Approved by the Office of Management and Budget under control number 1545-0869]

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

Approved June 17, 1985.

RONALD A. PEARLMAN,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on July 1, 1985, 8:45 a.m., and published in the issue of the Federal Register for July 2, 1985, 50 F.R. 27231)

Section 132.—Certain Fringe Benefits

26 CFR 1.132-1T: Questions and answers relating to the exclusion from gross income of certain fringe benefits (temporary).

Q/A-4a, concerning an employee's working condition fringe, is removed. See T.D. 8060, page 90.

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26 CFR 1.132-1T: Questions and answers relating to the exclusion from gross income of certain fringe benefits (temporary).

Determination of amount of an employee's working condition fringe with respect to employer-provided property or services. See T.D. 8061, page 93.

Part V.—Deductions for Personal Exemptions

Section 151.—Allowance of Deductions for Personal Exemptions

26 CFR 1.151-4: Amount of deduction for each exemption under section 151.

Adjusted personal exemption amount set forth for taxable years beginning in 1986. See Rev. Proc. 85-55, page 737.

Section 152.—Dependent Defined

26 CFR 1.152-1: General definition of a dependent.

Dependency exemption; child alive only momentarily; induced abortion expenses. Expenses incurred to induce an abortion do not qualify under section 152 of the Code as an item of support for a child born alive during the tax year. Rev. Rul. 73-156 clarified.

Rev. Rul. 85-118

ISSUE AND FACTS

Do expenses incurred to induce an abortion qualify under section 152 of the Internal Revenue Code as an item of support for a child born alive during the tax year?

LAW AND ANALYSIS

Section 151(e)(1)(B) of the Code provides for a dependency exemption for each dependent (as defined in section 152) who is a child of the taxpayer and who (i) has not attained the age of 19 at the close of the calendar year in which the taxable year of the taxpayer begins, or (ii) is a student.

Section 152(a)(1) of the Code provides that the term "dependent" means a son or daughter of the taxpayer, or a descendant of either, over half of whose support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer.

Section 1.152-1(a)(2)(i) of the Income Tax Regulations provides that the term "support" includes food, shelter, clothing, medical and dental care, education, and the like.

Rev. Rul. 73-156, 1973-1 C.B. 58, holds that a parent may claim a dependency exemption under section 151 of the Code for a child born alive during the taxable year, even though the child lives only momentarily, provided state or local law treats the child as having been born alive and the live birth is evidenced by an official document, such as a birth certificate. The ruling assumes, for purposes of its holding, that the "support" test of section 152 of the Code has been met.

The question of whether a taxpayer has met the support test of section 152(a)(1) of the Code is a question of fact, and the taxpayer claiming the dependency exemption must show, under all the facts and circumstances, that over one-half of the child's support was received from the taxpayer. Expenses

attributable to the support of the child, such as medical expenses, qualify as items of support for purposes of meeting the support test. *See* section 1.152-1(a)(2)(i) of the regulations. Expenses for an induced abortion, however, are not incurred for the benefit of the child and do not qualify as an item of support.

HOLDING

Expenses incurred for an induced abortion do not qualify under section 152 as an item of support for a child born alive during the tax year.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 73-156 is clarified.

Part VI.—Itemized Deductions for Individuals and Corporations

Section 162.—Trade or Business Expenses

26 CFR 1.162: Business expenses.

A commodity futures exchange clearing house corporation that funded a trust to satisfy a legal obligation is not entitled to a deduction for the amount of the contribution to the trust. See Rev. Rul. 85-158, page 175.

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26 CFR 1.162-17: Reporting and substantiation of certain business expenses of employees.

Increase in the optional standard mileage rate for deducting the cost of operating an automobile for business purposes. See Rev. Proc. 85-49, page 716.

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26 CFR 1.162-17: Reporting and substantiation of certain business expenses of employees.

Mileage allowance for transportation paid by employers to employees. See Rev. Rul. 85-155, page 89.

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26 CFR 1.162-25T: Deductions with respect to noncash fringe benefits (temporary).

Treatment by employers and employees of certain noncash fringe benefits. See T.D. 8061, page 93.

Section 163.—Interest

26 CFR 1.163-1: Interest deduction in general.

Interest; instruments issued by bank holding company. Certain instruments issued by a domestic bank holding company represent debt of the bank holding company for federal income tax purposes and, therefore, periodic payments by the bank holding company with respect to the instruments constitute interest for purposes of section 163 of the Code

Rev. Rul. 85-119

ISSUE

For federal income tax purposes, should the instruments described below be treated as debt, so that amounts to be paid periodically with respect thereto will be treated as interest for purposes of section 163 of the Internal Revenue Code, or should they be treated as equity?

FACTS

Corporation (HC) is a domestic bank holding company subject to regulation by the Federal Reserve Board (FRB). HC's stock is traded on a national securities exchange and is widely held. It owns 100 percent of the stock of a subsidiary engaged in the commercial banking business. HC proposes to issue for cash $100*x* of instruments (Notes) described below.

Under FRB guidelines, HC, as a bank holding company, must meet certain primary capital requirements. Under those guidelines, primary capital includes common and perpetual preferred stock, capital and undivided surplus, and a limited amount of "mandatory convertible debt." The guidelines further specify that a subordinated debt instrument that is issued by a bank holding company and that is payable in the issuer's common or perpetual preferred stock or redeemable with proceeds from the sale of such stock constitutes "mandatory convertible debt."

Notes will be issued in a public offering, will be widely held, and will not be held proportionately to HC's stock. They will be offered at 100 percent of their stated principal amount. Notes will be issued either in bearer or registered form, will be freely transferable, and will mature in 12 years. Noteholders will not be entitled to vote or to participate in the management of HC.

Under the terms of the Notes, amounts designated as interest are payable quarterly in cash at a floating rate comparable to the market rate on similar subordinated debt instruments payable in money at maturity. These amounts are payable without regard to HC's earnings. Regulatory and state corporate law restrictions generally applicable to the payment of dividends are not applicable to such payments. If HC defaults on its obligation to make these quarterly payments, Noteholders can sue to compel payment of the amounts then due.

Notes are unsecured and subordinated to all present and future claims of general creditors of HC. Payment of principal may be accelerated only upon the bankruptcy, insolvency, or reorganization of HC. Upon the occurrence of one of these events, Noteholders are entitled to payment in money, in an amount equal to the face amount of Notes plus periodic payments that have accrued but remain unpaid, before any payments are made to shareholders.

At maturity or at an earlier redemption date, HC is unconditionally obligated to issue, in exchange for Notes, its own common or perpetual preferred stock having an appraised fair market value equal to the principal amount of Notes. The class of stock to be exchanged for Notes is left largely to the discretion of HC, and is not determined until shortly before maturity or redemption. The stock will be registered with the Securities and Exchange Commission and will be publicly traded. Upon receipt of notice of maturity or redemption, Noteholders may elect to receive this stock as payment for their Notes. Under the terms of Notes, Noteholders who do not make the election will be deemed to have received such stock and to have appointed HC to sell such stock on their behalf in a secondary offering, with the proceeds to be delivered to the Noteholders on the maturity date. HC is unconditionally obligated to effect the secondary offering at its expense and to sell sufficient stock to result in the receipt by nonelecting Noteholders of net cash proceeds equal to the principal amount of Notes. Failure by HC to perform on its obligation to effect the secondary offering and to deliver cash equal to the principal amount of the Notes would constitute a breach of HC's obligation and would provide the Noteholders with a cause of action for money damages under state law.

HC generally has the option to redeem Notes for cash or to pay cash for Notes at maturity, without jeopardizing the status of Notes as mandatory con-

vertible debt under the FRB guidelines, provided that payment is made only with the proceeds from the sale by HC of its common or perpetual preferred stock. Payment from any other source must receive the approval of the FRB.

HC is not thinly capitalized. Whether the Notes constitute debt or equity, after their issuance HC will have a debt-equity ratio that is within the industry norm.

LAW AND ANALYSIS

Periodic payments made with respect to an instrument are deductible as interest under section 163 of the Code only if the instrument is a valid indebtedness of the payor. Whether an instrument represents indebtedness or an equity investment for federal income tax purposes depends on the facts and circumstances of each case. No particular fact is conclusive in making this determination. *John Kelley Co. v. Commissioner*, 362 U.S. 521 (1946), 1946-1 C.B. 191.

An analysis of all the terms and conditions of the instruments and all the facts and circumstances surrounding the issuance of the instruments indicates that HC and the purchasers of the instruments intend to create a debtor-creditor relationship, Rev. Rul. 68-54, 1968-1 C.B. 69; Rev. Rul. 73-122, 1973-1 C.B. 66, and that as a legal matter a debtor-creditor relationship will be created. Notes also contain many other attributes that are commonly treated as supporting debt characterization for federal income tax purposes. They are issued for cash at 100 percent of their face amount in a public offering, are widely held, are not held proportionately to HC's stock, and have been designated by the parties as debt. Amounts designated as interest are payable quarterly, irrespective of earnings, at a floating rate comparable to the market rate of interest on similar debt instruments payable in money. Any default on the payment of such amount or amounts results in a legally enforceable right in the Noteholders against HC for payment of the amount or amounts in default. The Notes remain outstanding for a limited 12-year term and do not contain any restrictions on transferability. In addition, HC is not thinly capitalized and its debt-to-equity ratio is within the industry norm. Noteholders are not entitled to vote or to participate in management. Finally, because the number of shares of stock to be issued at maturity in exchange for Notes is not fixed but is based on the face amount of Notes, Noteholders, during the term of the Notes, do not share in the increase or decrease in the market value of such HC stock. *Compare* Rev. Rul. 83-98, 1983-2 C.B. 40.

On the other hand, the subordination of the rights of Noteholders to the rights of general creditors as well as the provision for the issuance of stock in exchange for Notes at maturity are features indicating that Notes may constitute equity. Although Noteholders are subordinated to the rights of general creditors, on insolvency or bankruptcy Noteholders have the status of creditors and are entitled to priority, in payment of amounts denominated as principal and accrued but unpaid interest, over the claims of all shareholders. In form, Notes are payable at maturity in stock; however, for any Noteholder who does not elect to receive stock, HC is unconditionally obligated to effect a secondary offering of this stock and to deliver, at maturity, cash equal to the principal amount of Notes. Failure by HC to perform on its obligation to effect a secondary offering and to deliver cash equal to the principal amount of the Notes would constitute a breach of HC's obligation and would provide the Noteholders with a cause of action for money damages under state law. Accordingly, in substance, Notes are payable at the Noteholder's option in a fixed amount of cash or in stock of equivalent value.

HOLDING

Notes represent debt of HC for federal income tax purposes. Periodic payments with respect to Notes constitute interest deductible by HC under section 163 of the Code (provided the requirements contained therein are satisfied) and includible by Noteholders in income under Section 61.

No implication is intended as to the federal income tax treatment of any payments with respect to instruments issued under other facts and circumstances.

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26 CFR 1.163-1: Interest deduction in general.

Whether a minister may deduct interest and taxes paid on a personal residence if the amounts expended are allocable to a rental allowance that is otherwise excludable from gross income under a particular section of the Code. See Rev. Rul. 85-96, page 87.

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26 CFR 1.163-5T: Denial of interest deduction on certain obligations issued after December 31, 1982, unless issued in registered form. (Also 35a.9999-5.)

T.D. 8046

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER A, PART 1—INCOME TAX: TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 35a—TEMPORARY EMPLOYMENT TAX REGULATIONS UNDER THE INTEREST AND DIVIDEND TAX COMPLIANCE ACT OF 1983

Registration Requirements With Respect to Certain Debt Obligations; Sanctions on Issuers of Registration-Required Obligations Not in Registered Form; and the Application of the Repeal of 30 Percent Withholding by the Tax Reform Act of 1984.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains amendments to the temporary regulations issued under T.D. 7965 [1984-2 C.B. 38] and T.D. 7967 [1984-2 C.B. 329] and published in the Federal Register beginning at 49 FR 33228 and 49 FR 33239, respectively. These regulations relate to the definition of the term "registration-required obligation" with respect to certain obligations, the imposition of sanctions on issuers issuing registration-required obligations in bearer form, and the repeal of 30 percent withholding by the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. The regulations affect issuers of obligations held by foreign persons, issuers of certain other obligations, and payers and recipients of interest with respect to all such obligations. They provide the public with guidance necessary to comply with the Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462] and the Tax Reform Act of 1984. The text of these temporary regulations also serve as the text for an amended notice of proposed rulemaking published * * * [on page 808, this Bulletin].

DATES: The temporary regulations under §1.163-5T(d) (pass-through certificates) generally apply to obligations issued after December 31, 1982. The temporary regulations which amend the regulations issued by T.D. 7965 (issuer sanctions) are generally effective with respect to obligations originally issued after September 21, 1984. The temporary regulations which amend the regulations issued by T.D. 7967 (repeal of 30 percent withholding) are generally effective for payments made after September 19, 1985 with respect to obligations issued after July 18, 1984.

FOR FURTHER INFORMATION CONTACT: P. Ann Fisher of the Legislation and Regulations Division of the Division of the Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (202-566-3289, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

These temporary regulations amend existing temporary regulations issued previously relating to the definition of the term "registration-required obligation," the imposition of sanctions on issuers issuing registration-required obligations in bearer form and the repeal of 30 percent withholding.

NEED FOR AMENDMENT

The temporary regulations which are being amended did not specifically address the application of the definition of the term "registration-required obligation" under section 163(f)(2)(A) to pass-through certificates, such as mortgage pass-through certificates, the application of the sanctions on issuers of "registration-required obligations" not in registered form to the issuers of such certificates and the underlying obligations, or the application of the partial repeal of 30 percent withholding to these certificates.

The effective date provision of the temporary regulations issued on August 22, 1984, defining what obligations are described under section 163(f)(2)(B) (the "temporary foreign-targeting regulations"), applied these regulations to any obligation issued after September 21, 1984, including an obligation issued after September 21, 1984 either pursuant to the exercise of a warrant that was issued on or before September 21, 1984 or on the conversion of a convertible debt obligation issued on or before such date. The amendments provide that the temporary foreign-targeting regulations generally effective after September 21, 1984 do not apply to obligations issued either pursuant to the exercise of a warrant or the conversion of a convertible debt obligation that complied with earlier temporary regulations in effect when the warrant or convertible debt obligation was issued.

The temporary foreign-targeting regulations which are being amended do not clearly define the scope of the rule which states that a transfer to an account in the United States is considered to be a payment inside the United States, and these amendments more precisely define this scope.

Finally, the temporary regulations issued in question and answer form on the subject of the repeal of 30 percent withholding do not explain completely how the certification requirements for repeal apply to foreign-targeted registered obligations held by clearing organizations and by foreign branches of United States financial institutions, and these amendments provide a more complete explanation.

EXPLANATION OF PROVISIONS

Registration-required Obligations

This amendment provides that a pass-through or participation certificate evidencing an interest in a pool of mortgage loans which under Subpart E of Subchapter J of the Code is treated as a trust of which the grantor is the owner (or similar evidence of interest in a similar pooled fund or pooled trust treated as a grantor trust) ("pass-through certificate") is considered to be a "registration-required obligation" if the pass-through certificate is described in section 163(f)(2)(A), without regard to whether any obligation held by the fund or trust to which it relates is described in section 163(f)(2)(A). Also, a pass-through certificate is considered to satisfy the requirements of section 163(f)(2)(B) if it satisfies the requirements of section 163(f)(2)(B) without regard to the status of the underlying obligations. Mortgage pass-through certificates are therefore obligations to which section 163(f)(2)(A) or (B) may apply.

This amendment does not affect the determination of whether bearer obligations that are issued or guaranteed by the United States Government or backed by United States Government securities comply with the requirements of section 163(f)(2)(B) and the regulations thereunder.

The amendment is also contained in a cross-reference notice of proposed rulemaking and, in that regard, the Service is especially interested in receiving comments as to: (1) what should qualify as a similar pooled fund or pooled trust treated as a grantor trust for purposes of section 163(f)(2)(A) and (B) (see §1.163-5T(d)(1)) and (2) when the Commissioner's authority to characterize certificates (or similar evidences of interest in a pooled fund or pooled trust treated as a grantor trust) and obligations in accordance with the substance of the arrangement and to impose penalties as appropriate should be exercised (see §1.163-5T(d)(4)).

Issuer Sanctions

Under the temporary foreign-targeting regulations, an issuer of a bearer obligation that is otherwise a "registration-required obligation" is not subject to certain sanctions if the issuer complies with the requirements contained in the regulations, including the requirement that interest be paid outside the United States. The temporary regulations provide that interest paid by transfer into an account maintained by the payee of the United States is considered paid in the United States if it is paid on an obligation issued by a United States person, a controlled foreign corporation, or a foreign corporation if 50 percent or more of its gross income for the 3-year period preceding the original issuance of the obligation is effectively connected with the conduct of a trade or business within the United States. This rule does not apply to payments to persons described in section 165(j)(3)(A), (B), or (C) and the regulations thereunder. The purpose of this rule is to prevent United States persons (except those persons who are permitted to hold bearer obligations) from depositing interest or bearer obligations into their accounts maintained in the United States. The transfer of interest to a United States account of a financial institution should not be consid-

ered payment inside the United States if this transfer is merely a step in the clearance of funds and the interest is promptly credited to an account maintained outside the United States by the financial institution or by the person for which the financial institution has collected the interest. Therefore, this amendment provides an exception to permit a financial institution to have interest credited to an account it maintains in the United States if the payment is a step in the clearance of funds and the interest is promptly credited to an account maintained outside the United States by the financial institution or by the person for which the financial institution collected the interest.

This amendment also changes the effective date of the temporary foreign-targeting regulations. The prior effective date provision applied these regulations to an obligation issued after September 21, 1984. The amended effective date provision does not apply the temporary regulations issued on August 22, 1984 to an obligation issued after September 21, 1984 either purusant to the exercise of a warrant issue on or before September 21, 1984, or on the conversion of a convertible debt obligation issued on or before September 21, 1984. The amended effective date provision instead applies the rules provided in temporary regulation §5f.163-1(c), as in effect prior to its removal, to the determination of whether such as obligation issued after September 21, 1984 is described in section 163(f)(2)(B) and is therefore not required to be registered. However, an issuer who has substantially complied with the former proposed regulations provided in §1.163-5(c) (superseded on August 22, 1984 by the temporary foreign-targeting regulations issued on that date) will be considered to satisfy the requirements of section 163(f)(2)(B) with respect to an obligation issued after September 21, 1984 either pursuant to the exercise of a warrant issued on or before September 21, 1984 or on the conversion of a convertible debt obligation issued on or before September 21, 1984.

Repeal of 30 percent withholding

This amendment provides specific guidance on the application of the partial repeal of the 30 percent withholding tax to pass-through certificates. The amendment provides that interest paid to a holder of a pass-through certificate will qualify as portfolio interest under section 871(h)(2) or section 881(c)(2) if it is described in A-1 or A-8 of §35.9999-5, without regard to whether any obligations held by the fund or trust to which the pass-through certificate relates are described in A-1 or A-8. However, for purposes of A-1 and A-8 of §35a.9999-5 and section 127 of the 1984 Act, a pass-through certificate will be considered as issued after July 18, 1984 only to the extent that the obligations held by the fund or trust to which the pass-through certificate relates are issued after July 18, 1984.

This amendment also provides that a pass-through certificate is considered to be an obligation that would be a registration-required obligation but for the fact that it is described in section 163(f)(2)(B) if the pass-through certificate is not described in section 163(f)(2)(A)(i), (ii), or (iii) (without regard to whether any obligation held by the fund or trust to which it relates is so described) and if the pass-through certificate is described in section 163(f)(2)(B) (without regard to whether any obligation held by the fund or trust to which it relates is so described).

This amendment also provides additional guidance on the certification requirements applicable to foreign-targeted registered obligations and on the determination by a withholding agent that 30 percent withholding on a payment of interest on any registered obligation is not required because the payee is a United States person.

With respect to foreign-targeted registered obligations, this amendment clarifies that the certificate of non-United States beneficial ownership must always be given to the United States person who would otherwise be required to deduct and withhold tax. The certificate must generally relate to ownership of the obligation on interest payment dates during the preceding and forthcoming years. The amendment changes the frequency of filing the certificate from a filing within the period beginning 90 days prior to each interest payment date (an dending on that date) to a single annual filing during the period beginning on January 15 and ending on January 31 of each year for all foreign-targeted registered obligations that have been held at any time during the immediately past year and that will be acquired at any time during the forthcoming year by the person providing the certificate.

Withholding agents paying interest to beneficial owners that are neither financial institutions nor members of clearing organizations may accept a statement on a Form W-8 or substitute form that the beneficial owner is not a United States person. However, a withholding agent that is a foreign branch of a financial institution and a United States person need not receive a statement provided that the beneficial owner furnishes to the withholding agent documentary evidence, as defined in subdivision (iii) of Q & A 5 of §35a.9999-4T, to such effect.

The amendment provides that, if a United States person becomes a beneficial owner on an interest payment date, the withholding agent must be so notified within 30 days after such date. In such case the withholding agent is not required to withhold from the next interest payment if the withholding agent receives a Form W-9 (or a substitute form that is substantially similar) or a statement that the person who provides the notification of United States beneficial ownership is either a controlled foreign corporation or a corporation 50 percent or more of the gross income of which from the preceding 3 years was effectively connected with the conduct of a United States trade or business.

As noted, the amendment provides that the certificate provided to the withholding agent must relate only to ownership of the obligation on interest payment dates, not to any period between such dates. This is consistent with the provision under §1.1441-4(h) of the regulations, which states that tax is not required to be withheld on accrued interest paid by the buyer in connection with the sale of bonds between interest payment dates, even though the interest is subject to tax under section 871 or 881. The Internal Revenue Service is, however, studying the desirability of this provision. Any change with respect to the application of 30 percent withholding and any resulting change related to the exemption from 30 percent

withholding under sections 871(h) and 881(c), including applicable certification requirements, would be made in future regulations and would apply on a prospective basis only.

Although these admendments are generally effective for payments made after September 19, 1985, the certificate required to be filed with the withholding agent between January 15 and January 31, 1986, is not required to certify a foreign status of a beneficial owner of an obligation before the date of the certificate, and the certification requirements presently in effect will, with two exceptions, continue to apply to interest payments prior to the filing of the certificate between January 15 and January 31, 1986.

The first exception is that those provisions of the amendments relating to which persons are required to provide or receive certificates or statements will apply to interest payments beginning September 19, 1985. Thus, for example, the U.S. person who would otherwise be required to deduct and withhold tax on such interest payment must receive the certificate of non-United States beneficial ownership.

The second exception is that the provisions relating to the situation where the withholding agent pays interest directly to the beneficial owner will apply beginning on September 19, 1985.

Regulatory Flexibility Act and Executive Order 12291

The Commissioner of Internal Revenue has determined that this temporary regulation is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. The Internal Revenue Service has concluded that the regulations adopted hereby are interpretative and that the notice and public procedure requirements of 5 U.S.C. §553 do not apply. Accordingly, these regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

Need for Temporary Regulations

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision by reason of the continuous issuance of obligations to foreign persons and the repeal of 30% withholding on the interest on which obligations issued after July 18, 1984. For this reason, it is found impracticable to issue these temporary regulations with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

The Q&As are not intended to address comprehensively the issues raised by the repeal of 30 percent withholding. Taxpayers may rely on guidance on these Q&As, which the Internal Revenue Service will follow in resolving issues expressly raised herein arising under section 127 of the Tax Reform Act of 1984 and the information reporting and backup withholding rules affected thereby. No inference, however, should be drawn regarding questions not expressly raised and answered.

Drafting Information

The principal author of these temporary regulations is P. Ann Fisher of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance of style.

* * * * *

Adoption of Amendments to the Regulations

The following amendments to 26 CFR Parts 1, and 35a are hereby adopted:

Paragraph 1. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.163-5T is amended by revising paragraph (c)(2)(v) and (vi) and adding paragraph (d). The revised and added paragraphs read as follows:

§1.163-5T. Denial of interest deduction on certain obligations issued after December 31, 1982, unless issued in registered form.

* * * * *

(c) *Obligations issued to foreign persons after September 21, 1984.** * *

(2) *Rules for the application of this paragraph.** * *

(v) *Interest payable outside of the United States.* Interest will be payable only outside the United States and its posesssions if payment of such interest can be made only upon presentation of a coupon, or upon making of any other demand for payment, outside of the United States and its possessions to the issuer or a paying agent. The fact that payment is made by a draft drawn on a United States bank account or by a wire or other electronic transfer from a United States account does not affect this result. Interest payments will not be considered to be made outside of the United States if the payments are made by a transfer of funds into an account maintained by the payee in the United States or mailed to an address in the United States, if—

(A) The interest is paid on an obligation issued by either a United States person, a controlled foreign corporation as defined in section 957(a), or a foreign corporation if 50 percent or more of the gross income of the foreign corporation from all sources of the 3-year period ending with the close of its taxable year preceding the original issuance of the obligation (or for such part of the period that the foreign corporation has been in existence) was effectively connected with the conduct of a trade or business within the United States; and

(B) The interest is paid to a person other than—

(1) A person who may satisfy the requirements of section 165(j)(3)(A), (B), or (C) and the regulations thereunder; and

(2) A financial institution as a step in the clearance of funds and such interest in promptly credited to an account maintained outside the United States for such financial institution or for persons for which the financial institution has collected such interest.

Interest is considered to be paid within the United States and its possessions if a coupon is presented, or a demand for payment is otherwise made, to the issuer or a paying agent (whether a United States or foreign person) in the United States and its possessions even if the funds paid are credited to an account maintained by the payee outside the United States and its possessions. Interest will be considered payable only outside the United States and its possessions notwithstanding that such interest may become payable at the office of the issuer or its United States paying

agent under the following conditions: the issuer has appointed paying agents located outside the United States and its possession with the reasonable expectation that such paying agents will be able to pay the interest in United States dollars, and the full amount of such payment at the offices of all such paying agents is illegal or effectively precluded because of the imposition of exchange controls or other similar restrictions on the full payment or receipt of interest in United States dollars. A lawsuit brought in the United States or its possessions for payment of the obligation or interest thereon as a result of a default shall not be considered to be a demand for payment. For purposes of this subdivision (v), interest includes original issue discount as defined in section 1273(a). For purposes of determining the amount of original issue discount on an obligation described in paragraph (c)T(2)(i) which is part of an issue that neither is registered with the Securities and Exchange Commission nor is part of a privately placed issue, section 1273(a) shall apply as if the obligation were registered with the Securities and Exchange Commission.

(vi) *Rules relating to obligations issued on or before September 21, 1984.* Whether an obligation originally issued on or before September 21, 1984, or an obligation originally issued after September 21, 1984, pursuant to the exercise of a warrant or the conversion of a convertible obligation, which warrant or obligation (including conversion privilege) was issued on or before September 21, 1984, is described in section 163(f)(2)(B) shall be determined under the rules provides in §5f.163-1(c) as in effect prior to its removal. Notwithstanding the preceding sentence, an issuer will be considered to satisfy the requirements of section 163(f)(2)(B) with respect to an obligation issued on or before September 21, 1984 or after September 21, 1984 pursuant to the exercise of a warrant or the conversion of a convertible obligation, which warrant or obligation (including conversion privilege) was issued on or before September 21, 1984, if the issuer substantially complied with the proposed regulations provided in §1.163-5(c), which were published in the Federal Register on September 2, 1983 [48 FR 39953] and superseded by temporary regulations published in the Federal Register on August 22, 1984 [49 FR 33228].

(d) *Pass-through certificates.* (1) A pass-through or participation certificate evidencing an interest in a pool of mortgage loans which under Subpart E of Subchapter J of the Code is treated as a trust of which the grantor is the owner (or similar evidence of interest in a similar pooled fund or pooled trust treated as a grantor trust) ("pass-through certificate") is considered to be a "registration-required obligation" under section 163(f)(2)(A) and this section if the pass-through certificate is described in section 163(f)(2)(A) and this section, without regard to whether any obligation held by the fund or trust to which the pass-through certifiate relates is described in section 163(f)(2)(A) and this section. A pass-through certificate is considered to be described in section 163(f)(2)(B) and this section if the pass-through certificate is described in section 163(f)(2)(B) and this section, without regard to whether any obligation held by the fund or trust to which the pass-through certificate relates is described in section 163(f)(2)(B) and this section.

(2) An obligation held by a fund or trust in which ownership interests are represented by pass-through certificates is considered to be in registered form under section 103(j) and the regulations thereunder or to be described in section 163(f)(2)(A) or (B) if the obligation held by the fund or trust is in registered form under section 103(j) and the regulations thereunder or is described in section 163(f)(2)(A) or (B), respectively, without regard to whether the pass-through certificates are so considered.

(3) For purposes of section 4701, a pass-through certificate is considered to be issued solely by the recipient of the proceeds from the issuance of the pass-through certificate (hereinafter the "sponsor"). The sponsor is therefore liable for any excise tax under section 4701 that may be imposed with reference to the principal amount of the pass-through certificate.

(4) In order to implement the purpose of section 163 and this section, the Commissioner may characterize a certificate or other evidence of interest in a fund or trust which under Subpart E of Subchapter J of the Code is treated as a trust of which the grantor is the owner and any obligation held by such fund or trust in accordance with the substance of the arrangement they represent and may impose the penalties provided under sections 163(f)(1) and 4701 in the appropriate amounts and on the appropriate persons. This provision may be applied, for example, where a corporation issues obligations purportedly in registered form, contributes them to a grantor trust as its only assets, and arrange for the sale to investors of bearer certificates of interest in the trust which do not meet the requirements of section 163(f)(2)(B). If this provision is applied, the obligations held by the fund or trust will not be considered to be issued in registered form or to meet the requirements of section 163(f)(2)(B). The corporation will not be allowed a deduction for the payment of interest on the obligations held by the trust, and the exercise tax under section 4701, calculated with reference to the principal amount of the obligations held by the trust will be imposed on the corporation and may be collected from the corporation and its agents. This paragraph (d)(4) will not be applied so as to alter the tax consequences of transactions as to which rulings have been issued by the Internal Revenue Service prior to September 19, 1985.

(5) The rules set forth is this paragraph (d) apply solely for purposes of sections 4701, 163(f)(2)(A), 163(f)(2)(B), this section, and any other section that refers to this section for the definition of the term "registration-required obligation" (such as the regulations under sections 871(h) and 881(c)). The treatment of obligations described in this paragraph (d) for purposes of section 163(f)(2)(A) and (B) does not affect the determination of whether bearer obligations that are issued or guaranteed by the United States Government, a United States Government-owned agency, or a United States Government sponsored enterprise (within the meaning of §1.163-5T(c)(1)) or that are backed (as described in the Treasury Department News Release R-2835 of September 10, 1984 and Treasury Department News Release R-2847 of September 14, 1984) by obligations issued by the United States Government, a United States Government-owned agency, or a

United States Government sponsored enterprise comply with the requirements of section 163(f)(2)(B) and the regulations thereunder.

(6) *Example.* The provisions of this paragraph (d) may be illustrated by the following example:

Commercial Bank K forms a pool of 1000 residential mortgage loans, each made to a different individual homeowner, by assigning them to Commercial Bank L, an unrelated entity serving as trustee of the pool. Commercial Bank L immediately sells in a public offering certificates of interest in the trust of a maturity of 10 years in registered form. Commercial Bank L transfers the cash proceeds of the offering to Commercial Bank K. The certificates of interest in the trust are of a type offered to the public and are not described in section 163(f)(2)(B). Pursuant to paragraph (d)(1), the certificates of interest in the pool are registration-required obligations without regard to the fact that the obligations held by the trust are not registration-required obligations.

Par. 3. The authority for Part 35a continues to read in part:

Authority: 26 U.S.C. 871, 26 U.S.C. 881, 26 U.S.C. 1441, 26 U.S.C. 1442, and 26 U.S.C. 7805.

Par. 4. Section 35a.9999-5 is amended by—

1. Revising Q&As 10, 12, 14, and 15 of paragraph (b), and

2. Adding paragraph (d) consisting of Q&A 20. These revised and added provisions read as follows:

§35a.9999-5. Questions and answers relating to the repeal of 30 percent withholding by section 127 of the Tax Reform Act of 1984 and to the application of information reporting and backup withholding in light of such repeal.

* * * * *

(b) *Rules Concerning Obligations in Registered Form.** * *

Q-10. In the absence of the receipt of a certificate described in A-9 (or a certificate described in A-14 in the circumstances described in A-12) or a Form W-9 (or a substitute form that is substantially similar and completed under penalties of perjury), what United States persons are required to deduct and withhold tax under section 1441(a) or 1442(a) from interest otherwise qualifying as portfolio interest within the meaning of section 871(h)(2)(B) or 881(c)(2)(B)?

A–10. In general, any United States person who is otherwise a withholding agent for purposes of section 1441(a) or 1442(a) is required to deduct and withhold unless the certificate described in A-9 (or a certificate described in A-14 in the circumstances described in A-12) or a Form W-9 (or a substitute form that is substantially similar and completed under penalties of perjury) is received. However, a United States person is not required to withhold under section 1441(a) and 1442(a) regardless of whether the certificate is received under the following circumstances:

(i) The interest is paid to or collected on behalf of an exempt recipient at an address within the United States (other than an exempt recipient who is not a United States person); or

(ii) The interest is paid to a person at an address within the United States, and backup withholding is required with respect to that interest in accordance with the provisions of section 3406 (e.g., because neither a Form W-8 nor a Form W-9 has been received). For purposes of this A-10, an exempt recipient is a person described in §1.6049-4(c)(1)(ii).

* * * * *

Q-12. Is a United States person (including a foreign paying agent of an issuer who is a United States person) who is otherwise required to deduct and withhold tax in accordance with A-10 required to obtain the certificate described in A-9 with respect to interest on a registered obligation that has been targeted to foreign markets?

A-12. The certificate described in A-9 is not required with respect to interest paid on a registered obligation that is targeted to foreign markets (in accordance with the provisions of A-13) if the interest is paid by a United States person to a registered owner at an address outside the United States, provided that the registered owner is a financial institution described in section 871(h)(4)(B). In that case, the United States person otherwise required to deduct and withhold tax may treat the interest as portfolio interest if it does not have actual knowledge that the beneficial owner is a United States person and if it receives the certificate described in A-14 from a financial institution or member of a clearing organization, which member is the beneficial owner of the obligation, or the documentary evidence or statement described in A-14 from the beneficial owner, in accordance with the procedures described in A-15.

* * * * *

Q-14. What is the certificate or documentary evidence that may be provided in lieu of the Form W-8 (or substitute form) in the circumstances described in A-12?

A-14. No particular form is required for the certificate or documentary evidence in lieu thereof described in this A-14, but it must be described in either subdivision (i) or subdivision (ii). The certificate described in subdivision (i) is required if the United States person otherwise required to deduct and withhold tax (the "withholding agent") pays interest to a financial institution described in section 871(h) (4)(B) or to a member of a clearing orgnaization, which member is the beneficial owner of the obligation. The documentary evidence or statement described in subdivision (ii) is required if a withholding agent pays interest to a beneficial owner that is neither a financial institution described in section 871(h)(4)(B) nor a member of a clearing organization.

(i)(A) If the withholding agent pays interest to a financial institution described in section 871(h)(4)(B) or to a member of a clearning organization, which member is the beneficial owner of the obligation, the withholding agent must receive a certificate which states that, beginning at the time the last preceding certificate under this subdivision (i) was provided and while the financial institution or clearing organization member has held the obligation, with respect to each registered obligation that is targeted to foreign markets (in accordance with the provisions of A-13) which has been held by the person providing the certificate at any time since the provision of such last preceding certificate, either—

(1) The beneficial owner of the obligation has not been a United States person on each interest payment date; or

(2) If the person providing the certificate is a financial institution which is holding or has held an obligation on behalf of the beneficial owner, the beneficial owner of the obligation has been a United States person on one or more interest payment dates (identifying such date or dates), and the person making the certification has forwarded or will

forward the appropriate United States beneficial ownership notification to the withholding agent in accordance with the provisions of A-15.

The person providing the certificate need not state the foregoing where no previous cetificate has been required to be provided by the payee to the withholding agent under this subdivisiion (i).

(B) Whether or not a previous certificate has been required to be provided under this subdivision (i), each certificate under this subdivision (i) must further state that, with respect to each registered obligation that is targeted to foreign markets (in accordance with the provisions of A-13) held and every other such obligation to be acquired and held by the person providing the certificate during the period beginning on the date of the certificate and ending on the date the next certificate is required to be provided, the beneficial owner of the obligation will not be a United States person on each interest payment date while the financial institution or clearing organization member holds the obligation and that, if the person providing the certificate is a financial institution which is holding or will be holding the obligation on behalf of a beneficial owner, such person will provide a United States beneficial ownership notification to the withholding agent (and a clearing organization that is not a withholding agent where a member organization is required by this A-14 to furnish the clearing organization with a statement) in accordance with A-15 of this section in the event such certificate (or statement in the case of a statement provided by a member organization to a clearing organization that is not a withholding agent) is or becomes untrue with respect to any obligation. A clearing organization is an entity which is in the business of holding obligations for member organizations and transferring obligations among such members by credit or debit to the account of a member without the necessity of physical delivery of the obligation.

(C) The certificate described in subdivision (i)(A) and (B) must identify the obligations with respect to which it is given, except where the certification is given with respect to an obligation that has not been acquired at the time the certification is made. An obligation is identified if it or the larger issuance of which it is a part is described on a list (*e.g.*, $5 million principal amount of 12% debentures of ABC Savings and Loan Association due February 25, 1995, $3 million principal amount of 10% U.S. Treasury notes due May 28, 1990) of all registered obligations targeted to foreign markets held by or on behalf of the person providing the certificate and the list is attached to, and incorporated by reference into, the certificate. The certificate must identify and provide the address of the person furnishing the certificate.

(D) If the withholding agent pays interest to a depositary of a clearing organization, then the clearing organization must provide the certificate to the withholding agent.

(E) Any certificate that is provided by a clearing organization must state that the clearing organization has received a statement from each member which complies with this subdivision (i) of A-14 and with A-15 (as if the clearing organization were the withholding agent and regardless of whether the member is a financial institution described in section 871(h)(4)(B)).

(F) Subject to the requirements set out in A-15, a certificate or statement in the form described in this subdivision (i) of A-14, in conjunction with the next annual certificate or statement, will serve as the certificate that may be provided in lieu of a Form W-8 with respect to interest on all foreign-targeted registered obligations held by the person making the certification or statement and which is paid to such person within the period beginning on the date of the certificate and ending on the date the next certificate is required to be provided.

(ii) If the withholding agent pays interest to the beneficial owner of an obligation that is neither a financial institution described in section 871(h)(4)(B) nor a member of a clearing organization, then such owner must provide the withholding agent a Form W-8 (or substantially similar form completed under penalties of perjury) as set forth in A-9 of this section. However, a withholding agent that is a foreign branch of a financial institution described in section 871(h)(4)(B) and a United States person need not receive any statement or certificate from such beneficial owner, provided that the beneficial owner furnishes the withholding agent with documentary evidence as described in subdivision (iii) of Q-5 of §35a.9999-4T that the beneficial owner is not a United States person.

Q-15. What procedures apply with respect to the certificate described in A-14?

A-15. (i)(A) Where no previous certificate with respect to registered obligations that are targeted to foreign markets (in accordance with the provisions of A-13) has been provided to the withholding agent by the person providing the certificate under subdivision (i) of A-14, such certificate must be provided within the period beginning 90 days prior to the first interest payment date on which the person holds a foreign-targeted registered obligation. (The withholding agent may, in its descretion, withhold the tax under section 1441(a) or 1442(a) if the certificate is not received by the date 30 days prior to the interest payment.) Thereafter the certificate must be filed within the period beginning on January 15 and ending on January 31 of each year. If a certificate provided pursuant to the first sentence of this subdivision (i)(A) is provided during the period beginning on January 15 and ending on January 31 of any year, then no other certificate need be provided during such period in such year.

(B) If on any interest payment date after the obligation was acquired by the person making the certification the beneficial owner of the obligation is a United States person, then the person to whom the withholding agent pays interest must furnish the withholding agent with a United States beneficial ownership notification within 30 days after such interest payment date. A United States beneficial ownership notification must include a statement that the beneficial owner of the obligation has been a United States person on an interest payment date (identifying such date), that such owner has provided to the person providing the notification a Form W-9 (or a substitute form that is substantially similar to Form W-9 and completed under penalties of perjury), and that the person providing the notification has been and will be complying with the information reporting require-

ments of section 6049, if applicable.

(C) Where the person providing the notification described in subdivision (i)(B) of this A-15 is neither *(1)* a controlled foreign corporation within the meaning of section 957(a), nor *(2)* a foreign corporation 50 percent or more of the gross income of which from all sources for the three-year period ending with the close of the taxable year preceding the date of the statement was effectively connected with the conduct of trade or business in the United States, such person must attach to the notification a copy of the Form W-9 (or substitute form that is substantially similar to Form W-9 and completed under penalties of perjury) provided by the beneficial owner. When a person that provides the United States beneficial ownership notification does not attach to it a copy of such Form W-9 (or substitute form that is substantially similar to Form W-9 and completed under penalties of perjury), such person must state that it is *(1)* a controlled foreign corporation within the meaning of section 957(a), or *(2)* a foreign corporation 50 percent or more of the gross income of which from all sources for the three-year period ending with the close of its taxable year preceding the date of the statement was effectively connected with the conduct of a trade or business in the United States. A withholding agent that receives a Form W-9 (or a substitute form that is substantially similar to Form W-9 and completed under penalties of perjury) must send a copy of such form to the Internal Revenue Service Center, Cincinnati, OH. 45999, within 30 days after receiving it and must attach a statement that the Form W-9 or substitute was provided pursuant to this A-15 with respect to a United States person that has owned a foreign-targeted registered obligation on one or more interest payment dates.

(D) if either a Form W-9 (or a substitute form that is substantially similar to a Form W-9 and completed under penalties of perjury) or the statement described in subdivision (C) of this A-15 is not attached to the United States beneficial ownership notification provided pursuant to subdivision (i)(B) of this A-15, the withholding agent is required to withhold tax under section 871 or 881 on a payment of interest made after the withholding agent has received the notification unless such form or statement (or a statement that the beneficial owner of the obligation is no longer a United States person) is received before the interest payment date from the person who provided the notification (or transferee). If, during the period beginning on the next January 15 and ending on the next January 31, such person certifies as set out in subdivision (i)(A) and (B) of A-14 (except that such person does not certify under subdivision (i)(A)2 that it has forwarded all United States beneficial ownership notifications to the withholding agent in accordance with the provisions of A-15), then the withholding agent is not required to withhold tax during the year following such certification (unless such person again provides a United States beneficial ownership notification without attaching a Form W-9 or substitute form that is substantially similar to Form W-9 and completed under penalties of perjury or the statement described in subdivision (C) of this A-15).

(E) Within the period beginning 10 days before the end of the calendar quarter and ending on the last day of each calendar quarter, any clearing organization (including a clearing organization that is a withholding agent) relying on annual certificates or statements from its member organizations, as set forth in A-14 of this section, must send each member organization having submitted such certificate or statement a reminder that the member organization must give the clearing organization a United States beneficial ownership notification in the circumstances described in subsidivision (i)(B) of this A-15.

(F) The certificate described in subdivision (i) of A-14 must be retained in the records of the withholding agent for four years from the end of the calendar year in which it was received. The statement described in subdivision (i) of A-14 that is received by a clearing organization from a member organization must be retained in the records of the clearing organization for four years from the end of the calendar year in which it was received. The withholding agent who receives the certificate described in subdivision (i) of A-14 is not required to file Form 1042S to report payments of interest that are made with respect to foreign-targeted registered obligations held by the person providing the certificate and are made within the period beginning with the certificate date and ending on the last date for filing the next certificate.

(ii)(A) The documentary evidence (or Form W-8 or substantially similar form completed under penalties of perjury) described in subdivision (ii) of A-14 must be provided to the withholding agent within the period beginning 90 days prior to and ending on the first interest payment date on which the withholding agent pays interest to the beneficial owner. The withholding agent may, in its discretion, withhold the tax under section 1441(a) or 1442(a) if the documentary evidence (or Form W-8 or substantially similar form completed under penalties of perjury) is not received by the date 30 days prior to the interest payment. The beneficial owner must confirm to the withholding agent the continuing validity of the documentary evidence within the period beginning 90 days prior to the first day of the third calendar year following the provision of such evidence and during the same period every three years thereafter while the owner still owns the obligation. The withholding agent who receives the documentary evidence described in subdivision (ii) of A-14 is not required to file Form 1042S for payments of interest that are made with respect to foreign-targeted registered obligations held by the person who provides the documentary evidence and are made within the period beginning with the date on which the documentary evidence is provided and ending on the last date for confirming the validity of the documentary evidence. Where a Form W-8 (or substantially similar form completed under penalties of perjury) has been provided, it must be prepared, renewed, and retained in accordance with the procedures prescribed in §1.6049-5(b)(2)(iv) and must be attached to the form 1042S required to be filed with respect to the payment.

(B) If, on any interest payment date after the obligation was acquired by the person providing the documentary evidence (or Form W-8 or substantially similar form completed under penalties of perjury) described in subdivision (ii) of A-14, the beneficial owner of the

obligation is a United States person, then the beneficial owner must so inform the withholding agent within 30 days after such interest payment date and must provide a Form W-9 (or substitute form that is substantially similar completed under penalties of perjury) to the withholding agent. However, the beneficial owner is not required to provide another Form W-9 (or substitute form that is substantially similar and completed under penalties of perjury) if such person has already provided it to the withholding agent within the same calendar year.

(iii) In accordance with the provisions of section 871(h)(4), the Secretary may make a determination in appropriate cases that a certificate or statement by any person, or class of persons, does not satisfy the requirements of that section. Should that determination be made, all payments of interest that otherwise qualify as portfolio interest to that person would become subject to the 30 percent withholding tax.

(iv) Notwithstanding the foregoing requirements of A-14 and A-15 of this section,

(A) Any certificate that is required to be filed with the withholding agent during the period beginning on January 15 and ending on January 31, 1986 is not required to state that the beneficial owner of an obligation, prior to the date of the certificate, either was not a United States person or was a United States person if the obligation was acquired by the person providing the certificate on or before September 19, 1985; and

(B) All of the requirements of A-14 and A-15 of §35a.9999-5, as in effect prior to the effective date of these amendments, shall remain effective with respect to each interest payment prior to the filing of the certificate described in subdivision (A), except that *(1)* the provisions of A-14 relating to which persons are required to receive certificates or statements and *(2)* subdivisions (ii) of A-14 and (ii) of A-15 shall befcome effective with respect to each interest payment after September 19, 1985.

* * * * *

(d) *Application of the Repeal of 30 Percent Withholding to pass-through Certificates.*

Q-20. Will interest paid to a holder of a pass-through certificate as described in §1.163-5T(d)(1) qualify as portfolio interest for purposes of the exemption from 30 percent withholding under section 871(h)(2) or section 881(c)(2)?

A-20. (i) Interest paid to a holder of a pass-through certificate will qualify as portfolio interest under section 871(h)(2) or section 881(c)(2) for purposes of the exemption from 30 percent withholding if the interest satisfies the conditions described in A-1 or A-8 of this section. For purposes of A-1 and A-8 of this section and sections 871(h) and 881(c), interest is considered to be paid on or with respect to the pass-through certificate and not on or with respect to any obligations held by the fund or trust to which the pass-through certificate relates. Thus, except as set forth in the last sentence of this subdivision (i), interest paid to the holder of a pass-through certificate is portfolio interest if the pass-through certificate is described in A-1 or A-8 of this section, without regard to whether any obligation held by the fund or trust to which the pass-through certificate relates is described in A-1 or A-8 of this section. For example, a mortgage pass-through certificate in bearer form must meet the requirements set forth in A-1 of this section, but the obligations held by the fund or trust to which the mortgage pass-through certificate relates need not meet the requirements set forth in A-1 or A-8 of this section. However, for purposes of A-1 and A-8 of this section and section 127 of the Tax Reform Act of 1984, a pass-through certificate will be considered as issued after July 18, 1984 only to the extent that the obligations held by the fund or trust to which the pass-through certificate relates are issued after July 18, 1984.

(ii) Solely for purposes of A-1 of this section, a pass-through certificate is considered to be an obligation that would be a registration-required obligation within the meaning of section 163(f)(2)(A) but for the fact that it is described in section 163(f)(2)(B) if the pass-through certificate is not described in section 163(f)(2)(A)(i), (ii), or (iii) (without regard to whether any obligation held by the fund or trust to which the pass-through certificate relates is described in any of those subsections) and if the pass-through certificate is described in section 163 (f)(2)(B), without regard to whether any obligation held by the fund or trust to which the pass-through certificate relates is described in section 163(f)(2)(B).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved August 13, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 16, 1985, 10:29 a.m., and published in the issue of the Federal Register for August 20, 1985, 50 F.R. 33522)

Section 164.—Taxes

26 CFR 1.164-1: Deduction for taxes.

Whether a minister may deduct interest and taxes paid on a personal residence if the amounts expended are allocable to a rental allowance that is otherwise excludable from gross income under a particular section of the Code. See Rev. Rul. 85-96, page 87.

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26 CFR 1.164-1: Deduction for taxes.

Whether state income taxes paid by a political organization are deductible in computing political organization taxable income for federal income tax purposes under sections 164 and 527 of the Code. See Rev. Rul. 85-115, page 172.

Section 165.—Losses

26 CFR 1.165-1: Losses.

Are loss deductions allowed on the concurrent transfers of mortgage loan portfolios by three unrelated savings and loan associations where the transfers had no purpose or utility apart from the anticipated tax consequences? See Rev. Rul. 85-125, page 180.

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26 CFR 1.165-11: Election in respect of losses attributable to a disaster.

Losses; casualty; disaster areas; year of deduction. Disaster areas in which losses during 1985 qualify for special tax treatment under section 165(i) of the Code are listed.

Rev. Rul. 85-195

LAW AND ANALYSIS—HOLDING

Under section 165(i) of the Internal Revenue Code, if a taxpayer suffers a loss attributable to a disaster occurring in an area subsequently determined by the President of the United States to warrant assistance by the Federal Gov-

ernment under the Disaster Relief Act of 1974, sections 101 and 102, 42 U.S.C. sections 5121 and 5122 (1982), 1974-2 C.B. 414, then the taxpayer may elect to take a deduction for that loss on the taxpayer's federal income tax return for the taxable year immediately preceding the taxable year in which the disaster occurred.

The election to deduct for the preceding year must be made on or before the later of (1) the original due date of the taxpayer's income tax return for the year in which the disaster occurred, or (2) the due date of the preceding year's return (taking into account extensions of time for filing granted to the taxpayer). Section 1.165-11 of the Income Tax Regulations. This section of the regulations sets forth the procedures for making an election with respect to such losses.

The provisions of section 165(i) of the Code apply only to losses that are otherwise deductible under section 165(a). An individual taxpayer may deduct losses if they are incurred in a trade or business, if they are incurred in a transaction entered into for profit, or if they are casualty losses under section 165(c)(3).

As of November 30, 1985, the President had determined that the areas listed below have been adversely affected by disasters of sufficient severity occurring during 1985 to warrant disaster assistance by the Federal Government under the Disaster Relief Act of 1974.

There may be areas in which a disaster occurs during 1985 and which the President, after November 30, 1985, declares eligible for disaster assistance under the Disaster Relief Act of 1974. Information concerning these areas will be published in future issues of the Internal Revenue Bulletin, and these areas will be included in this revenue ruling when it is published in the Cumulative Bulletin.

Disaster Areas in 1985	Type of Disaster	Date Disaster Occurred or Began
Alabama		
Counties of Baldwin and Mobile	Hurricane Elena	September 2, 1985
California		
Counties of Los Angeles, Monterey, San Diego, San Luis, Obispo, Santa Clara, Santa Cruz, and Ventura	Grass, wildlands, and forest fires	June 26, 1985
Connecticut		
Counties of Fairfield, Hartford, Litchfield, Middlesex, New Haven, New London, Tolland, and Windham	Hurricane Gloria	September 27, 1985
Florida		
Counties of Dixie, Franklin, Hillsborough, Levy, Manatee, Pinellas and Wakulla	Hurricane Elena	August 29, 1985
Counties of Brevard, Broward, Charlotte, Collier, Dade, DeSota, Hardee, Hendry, Hillsborough, Indian River, Lake, Lee, Manatee, Orange, Osceola, Palm Beach, Pasco, Polk, Seminole, and St. Lucie	Severe freezing temperatures	January 20, 1985
Illinois		
Counties of Adams, Brown, Bureau, Calhoun, Cass, Clark, Crawford, Fulton, Greene, Grundy, Hancock, Jersey, LaSalle, Lee, Marshall, Mason, Monroe, Morgan, Peoria, Pike, Rock Island, Schuyler, Scott, Tazewell, Whiteside, Will, and Woodford	Severe storms and flooding	February 23, 1985

Disaster Areas in 1985	Type of Disaster	Date Disaster Occurred or Began
Louisiana		
Parishes of Ascension, Jefferson, LaFourche, Livingston, Orleans, Plaquemines, St. Bernard, St. Charles, St. John the Baptist, St. Tammany, Tangipahoa, and Terrebonne	Hurricane Juan	October 27, 1985
Massachusetts		
Counties of Barnstable, Berkshire, Bristol, Essex, Franklin, Hampden, Hampshire, Middlesex, Norfolk, Plymouth, Suffolk, and Worcester	Hurriciane Gloria	September 27, 1985
Michigan		
Counties of Alcona, Genesee, Iosco, Lapeer, Saginaw, and Shiawassee	Severe storms and flooding	September 5, 1985
Mississippi		
Counties of Hancock, Harrison, Jackson, Pearl River, and Stone	Hurricane Elena	September 2, 1985
New Jersey		
Counties of Atlantic, Cape May, Cumberland, and Monmouth	Hurricane Gloria	September 27, 1985
New York		
Counties of Erie and Niagara	Severe storms and flooding	February 23, 1985
Counties of Nassau and Suffolk	Hurricane Gloria	September 27, 1985
Ohio		
Counties of Ashtabula, Columbiana, Coshocton, Licking, Portage, and Trumbull	Severe storms and tornadoes	May 31, 1985
Pennsylvania		
Counties of Beaver, Butler, Clearfield, Crawford, Erie, Forest, Lycoming, McKean, Mercer, Northumberland, Union, Venango, and Warren	Severe storms and flooding	May 31, 1985
Counties of Carbon, Lackawanna, Luzerne, Susquehanna, Wayne, and Wyoming	Hurricane Gloria	September 27, 1985
Counties of Allegheny, Fayette, Greene, Somerset, Washington, and Westmoreland	Severe storms, landslides and flooding	November 3, 1985
Puerto Rico		
Municipalities of Adjuntas,	Storms, mud/land-	May 16, 1985

Disaster Areas in 1985	Type of Disaster	Date Disaster Occurred or Began
Anasco, Arecibo, Barceloneta, Barranquitas, Caguas, Ciales, Guayanilla, Humacao, Jayuya, Lares, Las Piedras, Maricao, Mayaguez, Orocovis, Santa Isabel, Utuado, Vega Baja, Villalba, and Yabucoa	slides and flooding	
Municipalities of Adjuntas, Aguas Buenas, Aibonito, Arecibo, Arroyo, Barceloneta, Barranquitas, Bayamon, Cayey, Ceiba, Ciales, Cidra, Coamo, Comerio, Dorado, Fajardo, Guanica, Guayama, Guayanilla, Guaynabo, Hormiqueros, Humacao, Jayuya, Juana Diaz, Lajas, Loiza, Manati, Maunabo, Morquis, Naguabo, Naranjito, Orocovis, Patillas, Penuelas, Ponce, Rio Grande, Salinas, San German, San Sebvastian, Santa Isabel, Toa Alta, Toa Beja, Trujillo Alto, Utuado, Vega Baja, Villalba, Yabucoa, and Yauco	Severe storms flooding and mudslides	October 4, 1985
Rhode Island		
Counties of Bristol, Kent, Newport, Providence, and Washington	Hurricane Gloria	September 27, 1985
Virginia		
Counties of Albemarle, Alexandria (City), Alleghany, Amherst, Appomattox, Augusta, Bath, Bedford, Botetourt, Buena Vista (City), Campbell, Chesterfield, Clarke, Clifton Forge (City), Covington (City), Craig, Essex, Fluvanna, Franklin, Gloucester, Goochland, Greene, Hampton (City), Harrisonburg (City), Henrico, Highland, King George, Lancaster, Lexington (City), Lynchburg (City), Madison, Mathews, Middlesex, Montgomery, Nelson, Northumberland, Page, Poquoson (City), Powhatan, Richmond, Richmond (City), Roanoke, Roanoke (City), Rockbridge, Rockingham, Salem (City), Shenandoah,	Severe storms, landslides and flooding	November 3, 1985

Disaster Areas in 1985	Type of Disaster	Date Disaster Occurred or Began
Stafford, Surry, Warren, Waynesboro (City), Westmoreland, and York		
West Virginia		
Counties of Barbour, Berkeley, Braxton, Calhoun, Doddridge, Gilmer, Grant, Greenbrier, Hampshire, Hardy, Harrison, Jefferson, Lewis, Marion, Mineral, Monongalia, Monroe, Morgan, Nicholas, Pendelton, Pocahontas, Preston, Randolph, Summers, Taylor, Tucker, Tyler, Upshur, and Webster	Severe storms, landslides and flooding	November 3, 1985
Wyoming		
County of Laramie	Severe storms, hail and flooding	August 1, 1985

Section 166.—Bad Debts

26 CFR 1.166-4: Reserve for bad debts.

An adjustment under section 481(a) of the Code is required when there is an integration under section 381(c)(4) of the bad debt reserve of a thrift institution, computed under section 593, into a reserve of an acquiring commercial bank, computed under section 585, because such action results in a change in method of accounting. See Rev. Rul. 85-171, page 148.

Section 167.—Depreciation

26 CFR 1.167(a)-1: Depreciation in general.

Increase in the optional standard mileage rate for deducting the costs of operating an automobile for business purposes. See Rev. Proc. 85-49 page 716.

Section 168.—Accelerated Cost Recovery System

26 CFR 1.168(j)-1T: Questions and answers concerning tax-exempt entity leasing rules.

T.D. 8033

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Tax-Exempt Entity Leasing

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary regulations regarding tax-exempt entity leasing. Changes to the applicable tax law were made by the Tax Reform Act of 1984 ("TRA") [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. These regulations provide guidance to persons executing lease agreements involving tax-exempt entities under section 168(j) of the Internal Revenue Code of 1954. In addition, the text of the temporary regulations set forth in this document serves as the comment document for the notice of proposed rulemaking published * * * [on page 841, this Bulletin].

DATE: In general, the regulations apply to leases involving tax-exempt entities entered into after May 23, 1983, and to property placed in service by the taxpayer after May 23, 1983. The revision to the safe harbor lease reporting requirements is effective with respect to such lease agreements executed after June 30, 1985.

ADDRESS INQUIRIES TO: Robert Beatson (Attn: LR-124-84), Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (202-566-3590).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains temporary regulations regarding tax-exempt entity leasing under section 168(j) of the Internal Revenue Code of 1954, as enacted by section 31 of TRA [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1, 17]. Since the tax-exempt entity leasing provisions generally became effective with respect to certain lease agreements entered into after May 23, 1983, there is a need for immediate guidance relating to basic issues regarding these provisions so taxpayers leasing property to certain tax-exempt entities can comply with these new provisions. These regulations will remain in effect until superseded by final regulations on this subject.

EXPLANATION OF PROVISIONS

Section 31 of TRA enacts a number of limitations regarding cost recovery deductions and tax credits applicable to certain property leased (or provided under a similar arrangement) to a tax-exempt entity such as a State or local governmental unit, an organization exempt from Federal taxation under section 501(c), or a foreign person who is generally not subject to Federal taxation. These limitations are intended to ensure that tax-exempt entities do not indirectly receive investment tax incentives through a lease (in the form of lower rent) that they would be ineligible to receive if they owned such prop-

erty. These provisions are generally intended to eliminate the ability of tax-exempt entities to effectively gain the advantage of income tax deductions and credits while having no corresponding liability to pay any tax on income from such property.

TRA reduces the tax benefits of lease arrangements involving tax-exempt entities by providing that the portions of real property constituting "tax-exempt use property" as defined by TRA which are leased to such entities generally must be depreciated over at least 40 years, and by providing that the portion of personal property constituting "tax-exempt use property" must generally be depreciated over at least a period defined by its ADR class mid-point life. TRA also provides clarification regarding when property is provided pursuant to a service contract rather than a lease. A number of basic issues regarding the tax-exempt leasing provisions are discussed in the following temporary regulations. In addition, provisions regarding the manner and times for making certain elections with respect to these provisions were published in Treasury Decision 7976 in the FEDERAL REGISTER for September 10, 1984 (49 F.R. 35486) [1984-2 C.B. 315].

These temporary regulations, presented in question and answer format, are intended to provide guidelines upon which taxpayers may rely to resolve the basic questions specifically set forth herein. No inference should be drawn regarding issues involving this or other Code sections not raised herein or reasons certain questions, and not others, are included in these regulations.

This document also contains temporary regulations revising the information reporting requirements for safe harbor lease agreements (not only permissible for qualified mass commuting vehicles as defined in section 103(b)(9)) executed after June 30, 1985. Form 6793, pertaining to safe harbor lease agreements, is obsolete for lease agreements executed after that date.

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Commission of Internal Revenue has determined that these temporary regulations are not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis therefore is not required.

REGULATORY FLEXIBILITY ACT

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) because these are temporary regulations, and there is a need to provide the public with immediate guidance. Accordingly, the Regulatory Flexibility Act does not apply and no Regulatory Flexibility Analysis is required for this rule.

PAPERWORK REDUCTION ACT

The collection of information requirements contained in this regulation have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these regulations is Robert Beatson of the Legislation and Regulations Division of the Office of the Chief Counsel, Internal Revenue Service. Personnel from other offices of the Internal Revenue Service and the Treasury Department participated, however, in developing the regulations on matters of both substance and style.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before these proposed regulations are adopted, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 1 and 602 are amended as follows:

1. These regulations are issued under the authority contained in 26 U.S.C. 7805 and 26 U.S.C. 168(j)(10). The authority citation for Part 1 is amended by adding "§1.168(f)(8)-1T also added under section 112(c) of the Black Lung Benefits Revenue Act of 1981 (Pub. L. 97-119) [1982-1 C.B. 307, 310]; and §1.168(j)-1T also added under 26 U.S.C. 168(j)(10)."

2. A new §1.48-12T is added immediately following §1.48-10(j) to read as follows:

§1.48-12T Tax-exempt entity leasing.

In general. For certain investment tax credit consequences for property which is tax-exempt use property under section 168(j), see §1.168(j)-1T.

3. A new §1.168(f)(8)-1T is added immediately following §1.168-7 to read as follows:

§1.168(f)(8)-1T Safe-harbor lease information returns concerning qualified mass commuting vehicles.

In general. Form 6793, Safe Harbor Lease Information Return, is obsolete for safe harbor lease agreements executed after June 30, 1985. The parties to a safe harbor lease agreement under section 168(f)(8) executed after June 30, 1985 must file with their timely filed (including extensions) Federal income tax returns for the taxable year during which the lease term begins a statement containing the following information:

(a) The name, address, and taxpayer identification number of the lessor and the lessee;

(b) A description of the property with respect to which safe-harbor lease treatment is claimed;

(c) The date on which the lessee places the property in service, the date on which the lease begins, and the term of the lease;

(d) The recovery property class of the leased property under section 168(c)(2) (for example, 5-year);

(e) The terms of the payments between the parties to the lease transaction;

(f) The unadjusted basis of the property as defined in section 168(d)(1) and its adjusted basis as determined under §5c.168(f)(8)-6(b)(3); and

(g) If the lessor is a partnership or grantor trust, the name, address, and taxpayer identification number of the partners or beneficiaries and the service center at which the income tax return

of each partner or beneficiary is filed. The lessor's failure to file the above-described statement shall void such agreement as a safe-harbor lease under section 168(f)(8) as of the date of the execution of the lease agreement. For rules regarding extensions of time for filing elections, see §1.9100-1.

4. A new §1.168(j)-1T is added immediately following §1.168(f)(8)-1T to read as follows:

§1.168(j)-1T Questions and answers concerning tax-exempt leasing rules.

The following questions and answers concern tax-exempt entity leasing under section 168(j) of the Internal Revenue Code of 1954, as enacted by section 31 of the Tax Reform Act of 1984 ("TRA") (Pub. L. 98-369) [1984-3 C.B. (Vol. 1) 1, 17]:

Consequences of tax-exempt use status:

Q-1. If recovery property is subject to the tax-exempt entity leasing provisions of section 168(j), how must the taxpayer compute the property's recovery deductions?

A-1. The taxpayer must compute the property's recovery deductions in accordance with section 168(j)(1) and (2); that is, the taxpayer must use the straight line method and the specified recovery period. For property other than 18-year real property, the applicable recovery percentages for the specified recovery period are to be determined with reference to the tables contained in Prop. Treas. Reg. §1.168-2(g)(3)(iv)(A). For 18-year real property for which a 40-year recovery period is required, the applicable recovery percentages are to be determined under the following table:

40-Year Straight Line Method (Assuming Mid-Month Convention)

If the recovery year is:	And the month in the first recovery year the property is placed in service is:											
	1	2	3	4	5	6	7	8	9	10	11	12
	The applicable recovery percentage is:											
1	2.4	2.2	2.0	1.8	1.6	1.4	1.1	0.9	0.7	0.5	0.3	0.1
2	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
3	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
4	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
6	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
7	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
8	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
9	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
10	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
11	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
12	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
13	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
14	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
15	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
16	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
17	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
18	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
19	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
20	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
21	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
22	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
23	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
24	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
25	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
26	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
27	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
28	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
29	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
30	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
31	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
32	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
33	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
34	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
35	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
36	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
37	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
38	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
39	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
40	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
41	0.1	0.3	0.5	0.7	0.9	1.1	1.4	1.6	1.8	2.0	2.2	2.4

Q-2. If recovery property that was placed in service after Deccember 31, 1980 by a taxable entity subsequently becomes tax-exempt use property, how are such property's cost recovery deductions under section 168 affected?

A-2. A change to tax-exempt use property, as defined in section 168(j)(3), will cause the cost recovery deductions under the accelerated cost recovery system (ACRS) to be recomputed. The allowable recovery deduction for the taxable year in which the change occurs (and for subsequent taxable years) must be determined as if the property had originally been tax-exempt use property. Proper adjustment must be made under the principles of Prop. Treas. Reg. §1.168-2(j)(3)(i)(B) to account for the difference between the deductions allowable with respect to the property prior to the year of change and those which would have been allowable had the taxpayer used the recovery period and method for tax-exempt use property under section 168(j)(1) and (2). However, no adjustment is made pursuant to the provisions of this A-2 if section 168(j)(2)(C) applies, that is, if the taxpayer had selected a longer recovery period in the year the property was placed in service than the recovery period prescribed for such property under section 168(j)(1).

Example (1). On July 1, 1983, X, a calendar year taxpayer, places in service 5-year recovery property with an unadjusted basis of $100. For 1983, X's allowable deduction is $15 (*i.e.*, .15 × $100). In 1984, the property becomes tax-exempt use property. Under section 168(j), assume the prescribed recovery period is 12 years. For 1984 (and subsequent taxable years), X's allowable deduction is determined as if the property had been tax-exempt use property since 1983, that is, the year it was placed in service. Thus, taxable year 1984 is the property's second recovery year of its 12-year recovery period. Additionally, X must account for the excess allowable recovery deduction of $11 (*i.e.*, the difference between the recovery allowance for 1983 ($15) and the allowance for that year had the property been tax-exempt use property ($4)) in accordance with the principles of Prop. Treas. Reg. §1.168-2(j)(3)(i)(B). Thus, the recovery allowances in 1984 and 1985 are $7.97, determined as follows:

Unadjusted basis multiplied by the applicable recovery percentage for second recovery year ($100 × .09)	$9.00
Excess allowable recovery deduction multiplied by the applicable recovery percentage for second recovery year divided by the sum of the remaining unused applicable percentages for tax-exempt use property existing as of the taxable year of change (1984) (($11 × .09)/.96)	− 1.03
Difference—allowable deduction for 1984	$7.97
Unadjusted basis multiplied by the applicable recovery percentage for third recovery year ($100 × .09)	$9.00
Excess allowable recovery deduction multiplied by the applicable recovery percentage for third recovery year divided by the sum of the remaining unused applicable percentages for tax-exempt use property existing as of the taxable year of change (1984) (($11 × .09)/.96)	− 1.03
Difference—allowable deduction for 1985	$7.97

Additionally, X must make a similar adjustment for the taxable years 1986 through 1995, that is, his fourth through thirteenth recovery years.

Example (2). Assume the same facts as in *Example (1)* except that in 1983, X elected under section 168(b)(3) with respect to the 5-year property to use the optional recovery percentages over a 25-year recovery period. Based on these facts, the provisions of this A-2 do not apply.

Definition of tax-exempt use property

—Mixed leases of real and personal property:

Q-3. How is a mixed lease of real property and personal property (*e.g.*, a building with furniture) to be treated for purposes of applying the rules of section 168(j)(3) defining which property constitutes tax-exempt use property?

A-3. The general rule is that 18-year real property and property other than 18-year real property are tested separately to determine whether each constitutes tax-exempt use property. However, if a lease of section 1245 class property is incidental to a lease of 18-year real property, and the 18-year real property is not tax-exempt use property, then the section 1245 class property also does not constitute tax-exempt use property. A lease of section 1245 class property will be considered incidental if the adjusted basis of all section 1245 class property leased in the same transaction is 1 percent or less of the adjusted basis of all 18-year real property leased in such transaction.

—Buildings which are partially tax-exempt use property:

Q-4. If part of a building is leased to a tax-exempt entity in a disqualified lease and part of the building is leased other than to a tax-exempt entity in a disqualified lease, to what extent do the tax-exempt entity leasing rules apply to such building?

A-4. The taxpayer must determine the amount of the building's unadjusted basis that is properly allocable to the portion of the building that is
exempt use property; the section 16
rules apply to the allocated amou
Solely for purposes of determin
what percentage of the building's b
is subject to the tax-exempt entity l
ing rules, no part of the basis is a
cated to common areas.

Example. A constructs a 3-story buildin
1984 at a cost of $900,000. Each floor consist
30,000 square feet. The only common a
(10,000 square feet) in the building is on the
floor. A leases the first floor (other than the c
mon areas) to a firm that is not a tax-exe
entity. A leases the top two floors to a
exempt entity in a 25-year lease. The top
floors constitute tax-exempt use property.
sume that square footage is the appropri
method for allocating basis in this case. Thus
must allocate $675,000 of the $900,000 basis
the tax-exempt use portion, determined
follows:

square footage of building which is tax-exempt use property (excluding common areas)	60,000 sq.
= total square footage in the building (excluding common areas)	80,000 sq.
	= ¾
¾ × $900,000	= $675,000

A must compute his recovery deductions
this portion of the basis ($675,000) in acco
ance with the rules of section 168(j)(1)
(2).

—Requirement of a lease:

Q-5. Can the use of property b
party other than a tax-exempt entity
sult in the property being treated as t
exempt use property within the mea
ing of section 168(j)(3)?

A-5. Yes, if based on all the fa
and circumstances it is more approp
ate to characterize the transaction a
lease to a tax-exempt entity. A transa
tion can be characterized as a lease t
tax-exempt entity under secti
168(j)(6)(A), which provides that "
term 'lease' includes any grant o
right to use property"; or under
service contract rules of secti
7701(e). See Q & A #18 for rules
garding service contracts.

Example. A trust is executed on January
1984, to create a pooled income fund (P)
meets the requirements of section 642(c)(5).
university (U) that is tax-exempt under sect
501(c)(3) is the remainderman of the pooled
come fund. P's purpose is to construct and op
ate an athletic center on land adjacent to
campus. Construction of the atheletic cent
which has a 50-year useful life, was comple
and the center was placed in service on Febru
1, 1985. The athletic center is managed for a
by M, an unrelated taxable organization wh
operates athletic facilities open to the public.
fice space at the facility is occupied rent-free

both the U athletic department and M. Scheduling of activities at the center is handled jointly by members of U's athletic department and M. General operating expenses of the athletic center are paid by P. Although the athletic center is open to the public for a membership fee, the majority of members are U's students who pay membership fees as part of their tuition. These fees are remitted by U to P. This arrangement is in substance a grant to U of a right to use the facility, and therefore a lease to U under section 168(j)(6)(A). U, as remainderman, will have obtained title to the entire building when the last pooled income fund donor dies. This arrangement is a disqualified lease because either (1) U has the equivalent of a fixed price purchase option under section 168(j)(3)(B)(ii)(II) (if U receives title as remainderman before the end of the useful life of the building), or (2) the lease has a term in excess of 20 years under section 168(j)(3)(B)(ii)(III) (if U does not receive title as remainderman until 20 years have elapsed), or both. Therefore, the allowable recovery deductions (without regard to salvage value) must be computed in accordance with section 168(j)(1) and (2). In addition, because this arrangement is treated as a lease under section 168(j), the facility is used by U for purposes of section 48(a)(4), and thus no investment tax credit is permitted with respect to any portion of the facility. This arrangement also may be treated as a lease to U for all purposes of chapter 1 of the Internal Revenue Code under section 7701(e).

—"More than 35 percent of the property" test:

Q-6. How is the percentage of 18-year real property leased to a tax-exempt entity in a disqualified lease to be determined for purposes of the "more than 35 percent of the property" test of section 168(j)(3)(B)(iii)?

A-6. The phrase "more than 35 percent of the property" means more than 35 percent of the net rentable floor space of the property. The net rentable floor space in a building does not include the common areas of the building, regardless of the terms of the lease. For purposes of the "more than 35 percent of the property" rule, two or more buildings will be treated as separate properties unless they are apart of the same project, in which case they will be treated as one property. Two or more buildings will be treated as part of the same project if the buildings are constructed, under a common plan, within a reasonable time of each other on the same site and will be used in an integrated manner.

Q-7. Are disqualified leases to different tax-exempt entities (regardless of whether they are related) aggregated in determining whether 18-year real property is tax-exempt use property?

A-7. Yes.

Example. A tax-exempt entity participates in industrial development bond financing for the acquisition of a new building by a taxable entity. The tax-exempt entity leases 60 percent of the net rentable floor space in the building for 5 years. Sixty percent of the building is tax-exempt use property. If the same tax-exempt entity leased only 19 percent of the net rentable floor space in the building for 5 years, no portion of the building would be tax-exempt use property because not more than 35 percent of the property is leased to a tax-exempt entity pursuant to a disqualified lease. If such tax-exempt entity leased only 19 percent of the net rentable floor space in the building for 5 years and another tax-exempt entity leased 20 percent of the net rentable floor space in the building for a term in excess of 20 years (or a related entity leased 20 percent of the building for 5 years), 39 percent of the building would be tax-exempt use property. See A-4 regarding the determination of the amount of the building's unadjusted basis that is properly allocable to the portion of the building that is tax-exempt use property.

—"Predominantly used" test:

Q-8. What does the term "predominantly used" mean for purposes of the section 168(j)(3)(D) exception to the tax-exempt use property rules?

A-8. "Predominantly used" means that for more than 50 percent of the time used, as determined for each taxable year, the real or personal property is used in an unrelated trade or business the income of which is subject to tax under section 511 (determined without regard to the debt-financed income rules of section 514). If only a portion of property is predominantly used in an unrelated trade or business, the remainder may nevertheless be tax-exempt use property.

Q-9. How is the "predominantly used" test of section 168(j)(3)(D) to be applied to a building?

A-9. The "predominantly used" test is to be applied to a building in the following manner:

(i) Identify the discrete portions (excluding common areas) of the building which are leased to a tax-exempt entity in a disqualified lease under section 168(j)(3)(B)(ii). A discrete portion of a building is an area physically separated from other areas. An area is physically separated from other areas if separated by permanent walls or by partitions serving as room dividers if such partitions remain in place throughout the taxable year. A discrete portion can be the entire building, floors, wings, offices, rooms, or a combination thereof. For example, a building whose entire internal space consists of a single large room used as a gymnasium has only one discrete portion. On the other hand, if the building has 3 stories with 10 offices on each floor, each of the 30 offices is a discrete portion.

(ii) Determine whether each discrete portion is predominantly used in an unrelated trade or business subject to tax under section 511. See A-8 for the rules regarding how to make this determination.

(iii) Once the discrete portions of the building that constitute tax-exempt use property have been identified, an appropriate allocation of basis must be made to such discrete portions. See A-4 for rules regarding how to make such allocation.

(iv) The application of these rules is illustrated by the following example:

Example. A building, constructed in 1985, is leased in its entirety to a tax-exempt entity (E) pursuant to a 25-year lease. The building has 25,000 square feet of net rentable floor space and consists of an auditorium (15,000 square feet), a retail shop (10,000 square feet), plus common area of 5,000 square feet. E uses the auditorium 80 percent of the time in its exempt activity and 20 percent of the time in an unrelated trade or business subject to tax under section 511. The retail shop is used 90 percent of the time in an unrelated trade or business subject to tax under section 511 and 10 percent of the time in an exempt activity. Thus, the auditorium is tax-exempt use property; the retail shop is not. An appropriate allocation of basis to the auditorium must be made. See A-4.

Definition of tax-exempt entity:

Q-10. What elections must be made in order to avoid the "5-year lookback" rule of section 168(j)(4)(E)(i)?

A-10. Only organizations which were exempt from tax under section 501(a) as organizations described in section 501(c)(12) (and which are no longer tax-exempt) may avoid the 5-year lookback rule of section 168(j)(4)(E)(i). In order to avoid the 5-year lookback rule with respect to any property, two elections are required. First, the organization must elect not to be exempt from tax under section 501(a) during the tax-exempt use period (as defined in section 168(j)(4)(E)(ii)(II)) with respect to the property. Second, the organization must elect to be taxed on the exempt arbitrage profits as provided in section 341(g)(16) of the Tax Reform Act of

1984. See Temp. Treas. Reg. §5h.4(a) for the time and manner of making these elections. These elections, once made, are irrevocable.

Q-11. Does the term "tax-exempt entity" include tax-exempt plans of deferred compensation and similar arrangements?

A-11. Yes. For purposes of section 168(j), the term "tax-exempt entity" includes trusts or other entities that are tax-qualified under section 401(a), individual retirement accounts, simplified employee pensions, and other tax-exempt arrangements described in subchapter D of chapter 1 of the Internal Revenue Code.

Special rules for high technology equipment:

Q-12. What effect do the tax-exempt entity leasing provisions have on "qualified technological equipment"?

A-12. "Qualified technological equipment" which is leased to a tax-exempt entity for a term of 5 years or less shall not constitute tax-exempt use property. If "qualified technological equipment" which is leased to a tax-exempt entity for a term of more than 5 years constitutes tax-exempt use property (as defined in section 168(j)(3)) and is not used predominantly outside the United States, the rules of section 168(j)(1) and (2) apply except that the recovery period to be used for such equipment shall be 5 years regardless of the length of the lease term. For purposes of section 168(j)(5), "qualified technological equipment" means (1) any computer or peripheral equipment, (2) any high technology telephone station equipment installed on the customer's premises, and (3) any high technology medical equipment. For definitions of these terms, see A-13 through A-16.

Q-13. What is a "computer" as that term is used in section 168(j)(5)(C)(i)(I)?

A-13. Computers are electronically activated devices that are programmable by the user and that are capable of accepting information, applying prescribed processes to it, and supplying the results of those processes with or without human intervention. Computers consist of a central processing unit containing extensive storage, logic, arithmetic, and control capabilities. A computer does not include any equipment which is an integral part of property that is not a user-programmable device, any video games or other devices used by the user primarily for amusement or entertainment purposes, or any typewriters, calculators, adding or accounting machines, copiers, duplicating equipment, or similar equipment. A computer does not include any equipment that is not tangible personal property.

Q-14. What is "peripheral equipment" as that term is used in section 168(j)(5)(C)(i)(I)?

A-14. Peripheral equipment means tangible personal property such as auxiliary machines, whether on-line or off-line, that are designed to be placed under the control of the central processing unit of the computer. Some examples of peripheral equipment are: card readers, card punches, magnetic tape feeds, high speed printers, optical character readers, tape cassettes, mass storage units, paper tape equipment, keypunches, data entry devices, teleprinters, terminals, tape drives, disc drives, disc files, disc packs, visual image projector tubes, card sorters, plotters, and collators. Peripheral equipment does not include equipment not included in Asset Depreciation Range (ADR) 00.12 listed in section 3 of Rev. Proc. 83-35, 1983-1 C.B. 745, 746. Peripheral equipment also does not include any equipment that is an integral part of property that is not a user-programmable device, any video games or other devices used by the user primarily for amusement or entertainment purposes, or any typewriters, calculators, adding or accounting machines, copiers, duplicating equipment, or similar equipment.

Q-15. What does "high technology telephone station equipment" mean as that term is used in section 168(j)(5)(C)(i)(II)?

A-15. High technology telephone station equipment includes only tangible personal property described in asset depreciation range (ADR) class 48.13 listed in section 3 of Rev. Proc. 83-35, 1983-1 C.B. 745, 758 that has a high technology content and which, because of such high technology content, can reasonably be expected to become obsolete before the expiration of its physical useful life. For example, telephone booths and telephones which include only a standard dialing feature are not highly technology equipment. However, telephones with features such as an abbreviated dialing short program, an automatic callback, or conference call feature may qualify as high technology equipment. High technology telephone station equipment may include terminal equipment including such extra features but not terminal equipment used in conjunction with features offered through central office capacity. There are no current plans to utilize the regulatory authority provided in section 168(j)(5)(C)(iv).

Q-16. What is "high technology medical equipment" as that term is used in section 168(j)(5)(C)(i)(III)?

A-16. High technology medical equipment is any electronic, electromechanical, or computer-based high technology equipment which is tangible personal property used in the screening, monitoring, observation, diagnosis, or treatment of human patients in a laboratory, medical, or hospital environment. High technology medical equipment includes only equipment that has a high technology content and which, because of such high technology content, can reasonably be expected to become obsolete before the expiration of its physical useful life. High technology medical equipment may include computer axial tomography (C.A.T.) scanners, nuclear magnetic resonance equipment, clinical chemistry analyzers, drug monitors, diagnostic ultrasound scanners, nuclear cameras, radiographic and fluoroscopic systems, Holter monitors, and bedside monitors. Incidental use of any such equipment for other purposes, such as research, will not prevent it from qualifying as high technology medical equipment. There are no current plans to utilize the regulatory authority provided in section 168(j)(5)(C)(iv).

Lease term:

Q-17. What is included in determining the length of a lease term?

A-17. (i) The lease term starts when the property is first made available to the lessee under the lease. The lease term includes not only the stated duration, but also any additional period of time which is within the "realistic contemplation of the parties at the time the property is first put into service."

Hokanson v. Commissioner, 730 F.2d 1245, 1248 (9th Cir. 1984). A subsequent period of time is included in the term of the original lease if the circumstances indicate that the parties, upon entering into the original lease, had informally agreed that there would be an extension of the original lease.

(ii) With respect to personal property, the lease term includes all periods for which the tax-exempt lessee or a related party (as defined under section 168(j)(7)) has a legally enforceable option to renew the lease, or the lessor has a legally enforceable option to compel its renewal by the tax-exempt entity or a related party. This is true regardless of the renewal terms of the lease agreement or whether the lease is in fact renewed.

(iii) With respect to real property, the lease term includes all periods for which the tax-exempt lessee or a related party (as defined under section 168(j)(7)) has a legally enforceable option to renew the lease, or the lessor has a legally enforceable option to compel its renewal by the tax-exempt entity or a related party, unless the option to renew is at fair market value, determined at the time of the renewal. The *Hokanson* facts and circumstances test (see (i) above) may cause the term of a fair market value renewal option to be treated as part of the original lease term.

(iv) Successive leases that are part of the same transaction or a series of related transactions concerning the same or substantially similar property shall be treated as one lease. This rule applies if at substantially the same time or as part of one arrangement the parties enter into multiple leases covering the same or substantially similar property, each having a different term. If so, then the original lease term will be treated as running through the term of the lease that has the last expiration date of the multiple leases. The multiple lease rule will not apply merely because the parties enter into a new lease at fair market rental value at the end of the original lease term.

(v) The application of the above rules is illustrated by the following examples:

Example (1). On December 30, 1984, X, a taxable corporation, and Y, a tax-exempt entity, enter into a requirements contract for a period of 3 years. The requirements contract sets the terms and conditions under which X and Y will do business on those occasions when X actually leases items of personal property to Y. The requirements contract imposes no obligation on either party to actually enter into a lease agreement. Pursuant to this requirements contract, on January 1, 1985, X and Y enter into three separate leases. Under the leases, Y obtained the use of three identical items of personal property, each for a term of six months beginning on January 1, 1985. On March 1, 1985, Y entered into a fourth lease for the use of a fourth item of personal property substantially similar to the other three items for a term of 20 months beginning on that date. The mere fact that all 4 leases were entered into pursuant to the same requirements contract and involved the same or substantially similar property does not require aggregation of the terms of such leases under section 168(j)(6)(B).

Example (2). Assume the same facts as in Example (1) except that, instead of the 4 leases entered into in Example (1), on January 1, 1985, pursuant to the requirements contract, X and Y enter into a lease for an item of personal property for one year. On January 10, 1986, after the end of the one-year lease term, X and Y enter into a second lease with respect to the same or substantially similar equipment. Assuming that the requirements contract itself is not a lease and assuming that the parties did not have any informal or implicit understanding (other than the general expectation of doing some business in the future) to enter into the second lease when the first lease was entered into, these two leases are not aggregated. The mere fact that the parties entered into two leases under the requirements contract does not result in the application of the section 168(j)(6)(B) rules for successive leases.

Example (3). The facts are the same as in *Example (2)* except that the parties did have an understanding, informal or otherwise, at the time of the first lease that they would enter into a second lease of the same personal property. The terms of the leases are aggregated.

Example (4). The fact are the same as in *Example (2)* except that, instead of the leases entered into in Example (2), on January 1, 1985, X and Y enter into two separate leases, each for a term of one year. One lease is for the period beginning on January 1, 1985 and ending on December 31, 1985. The other lease is for the period beginning on January 1, 1986 and ending on December 31, 1986. Both leases involve the same or substantially similar personal property. Under the successive lease rule, the terms of both leases are aggregated for purposes of determining the term of either lease under section 168(j)(6)(B). This result occurs because the two leases were entered into as part of the same transaction, and they relate to the same or substantially similar personal property.

Service contract issues:

Q-18. How is the treatment of service contracts affected by the service contract rules set forth in section 7701(e)?

A-18. If a contract which purports to be a service contract is treated as a lease under section 7701(e), such contract is to be treated as a lease for all purposes of Chapter 1 of the Internal Revenue Code (including , for example, section 168(j) and section 48(a)(4) and (5)).

Q-19. Does a contract to provide heating, maintenance, etc. services in low-income housing come within the low-income housing exception in section 7701(e)(5) to the service contract rules set forth in section 7701(e)?

A-19. No. Although certain low-income housing operated by or for an organization described in paragraphs (3) or (4) of section 501(c) is not subject to the service contract rules in section 7701(e), a contract, for instance, to provide heating services to low-income housing units, such as by installing and operating a furnace, does not constituent "low-income housing" within the meaning of section 7701(e)(5). Thus, the rules of section 7701(e) apply to such contracts in determining whether they are properly treated as leases.

Partnership issues:

Q-20. Do the provisions applicable to property leased to partnerships, set forth in section 168(j)(8), and the provisions applicable to property owned by partnerships, set forth in section 168(j)(9), apply to pass-through entities other than partnerships?

A-20. Yes. Rules similar to those provided in paragraphs (8), (9)(A), (9)(B), and (9)(C) of section 168(j) and those provided in Q & A's 21-26 apply to pass-through entities other than partnerships.

Q-21. What rules apply to property owned by a partnership in which one or more partners is a tax-exempt entity?

A-21. If property is owned by a partnership having both taxable and tax-exempt entities as partners, and any allocation to a tax-exempt entity partner is not a "qualified allocation" under section 168(j)(9)(B), then such entity's proportionate share of the property is to be treated as tax-exempt use property for all purposes. However, the property will not be tax-exempt use property if it is predominantly used by the partnership in an activity which, with respect to the tax-exempt entity, is an unrelated trade or business. An activity is an unrelated trade or business with respect to a tax-exempt entity if such entity's distributive share of the partnership's gross income from the activity is in-

cludible in computing its unrelated business taxable income under section 512(c) (determined without regard to the debt-financed income rules of section 514). A tax-exempt entity partner's proportionate share of property of a partnership equals such partner's share of that item of the partnership's income or gain (excluding income or gain allocated under section 704(c)) in which the tax-exempt entity has the highest share. If the tax-exempt entity partner's share of any item of income or gain (excluding income or gain allocated under section 704(c)) may vary during the period it is a partner, the previous sentence shall be applied with reference to the highest share of any such item that it may receive at any time during such period. The application of these rules is illustrated by the following example:

Example. A partnership (P) operates a factory, which consists of a building and various items of machinery. P has one tax-exempt entity (E) as a partner, and E's proportionate share is 10 percent (*i.e.*, 10 percent is the largest share of any item of income or gain that E may receive during the time E is a partner). Unless P's allocations to E are qualified under section 168(j)(9)(B), 10 percent of each item of partnership property (including the building) is tax-exempt use property, notwithstanding the 35 percent threshold test of section 168(j)(3)(B)(iii) that is otherwise applicable to 18-year real property. However, the property will not be tax-exempt use property if it is predominantly used by the partnership in an activity which, with respect to E, is an unrelated trade or business (determined without regard to the debt-financed income rules of section 514).

Q-22. What constitutes a "qualified allocation" under section 168(j)(9)(B)?

A-22. (i) A "qualified allocation" means any allocation to a tax-exempt entity which is consistent with such entity's being allocated the same share (*i.e.*, the identical percentage) of each and every item of partnership income, gain, loss, deduction, credit, and basis during the entire period such entity is a partner. Except as provided in A-23, an allocation is not qualified if it does not have substantial economic effect under section 704(b). However, for purposes of the two preceding sentences, items allocated under section 704(c) (relating to contributed property) are not taken into account. An allocation is not a "qualified allocation" under section 168(j)(9)(B) if the partnership agreement provides for, or the partners have otherwise formally or informally agreed to, any change (regardless of whether such change is contingent upon the happening of one or more events) in the tax-exempt entity's distributive share of income, gain, loss, deduction, credit, or basis at any time during the entire period the tax-exempt entity is a partner.

(ii) A change in a tax-exempt entity's distributive share of income, gain, loss, deduction, credit, or basis which occurs as a result of a sale or redemption of a partnership interest (or portion thereof) or a contribution of cash or property to the partnership shall be disregarded in determining whether the partnership allocations are qualified, provided that such transaction is based on fair market value at the time of the transaction and that the allocations are qualified after the change. For this purpose the consideration determined by the parties dealing at arm's length and with adverse interests normally will be deemed to satisfy the fair market value requirement. In addition, a change in a tax-exempt entity's distributive share which occurs as a result of a partner's default (other than a prearranged default) under the terms of the partnership agreement will be disregarded, provided that the allocations are qualified after the change, and that the change does not have the effect of avoiding the restrictions of section 168(j)(9). Any of the above-described transactions between existing partners (and parties related to them) will be closely scrutinized.

Example (1). A, a taxable entity, and B, a tax-exempt entity, form a partnership in 1985. A contributes $800,000 to the partnership; B contributes $200,000. The partnership agreement allocates 95 percent of each item of income, gain, loss, deduction, credit, and basis to A; B's share of each of these items is 5 percent. Liquidation proceeds are, throughout the term of the partnership, to be distributed in accordance with the partner's capital account balances, and any partner with a deficit in his capital account following the distribution of liquidation proceeds is required to restore the amount of such deficit to the partnership. Assuming that these allocations have substantial economic effect within the meaning of section 704(b)(2), they are qualified because B's distributive share of each item of income, gain, loss, deduction, credit, and basis will remain the same during the entire period that B is a partner. The fact that the liquidation proceeds may be distributed in a ratio other than 95 percent/5 percent does not cause the allocations not to be qualified.

Example (2). A, B, and E are members of a partnership formed on July 1, 1984. On that date the partnership places in service a building and section 1245 class property. A and B are taxable entities; E is a tax-exempt entity. The partnership agreement provides that during the first 5 years of the partnership, A and B are each allocated 40 percent of each item of income, gain, loss, deduction, credit, and basis; E is allocated 20 percent. Thereafter, A, B, and E are each allocated 33 1/3 percent of each item of income, gain, loss, deduction, credit, and basis. Assume that these allocations meet the substantial economic effect test of section 704(b)(2) and E's distributive share of the partnership's income is not unrelated trade or business income subject to tax under section 511. The allocations to E are not qualified allocations under section 168(j)(9)(B) because E's distributive share of partnership items does not remain the same during the entire period that E is a partner in the partnership. Thus, 33 1/3 percent of the building and 33 1/3 percent of the section 1245 class property are tax-exempt use property from the time each is placed in service by the partnership and are thus subject to the cost recovery rules of section 168(j)(1) and (2). In addition, no investment tax credit is allowed for 33 1/3 percent of the section 1245 class property because of section 48(a)(4).

Q-23. In determining whether allocations constitute qualified allocations, what rules are applied to test allocations that are not governed by the substantial economic effect rules?

A-23. A-22 provides the general rules to be used in determining whether an allocation is a qualified allocation, including the rule that the allocation must have substantial economic effect. However, certain allocations are not governed by the substantial economic effect rules (*e.g.*, an allocation of basis of an oil and gas property is generally governed by section 613A(c)(7)(D), rather than section 704(b)), and other allocations cannot satisfy the substantial economic effect rules (*e.g.*, allocations of credits, allocations of deduction and loss attributable to nonrecourse debt, and allocations of percentage depletion in excess of basis). Since allocations in either of these categories cannot be tested under the substantial economic effect test, these allocations, in order to be qualified, must comply with the relevant Code or regulation section that governs the particular allocation (*e.g.*, in the case of an allocation of basis of an oil and gas property, section 613A(c)(7)(D)).

Q-24. Will the Internal Revenue Service issue letter rulings on the issue of whether an allocation is a "qualified allocation" for purposes of section 168(j)(9)?

A-24. The Internal Revenue Service will accept requests for rulings on the question of whether an allocation is a "qualified allocation" for purposes of

section 168(j)(9). Such requests should be submitted in accordance with the appropriate revenue procedure. One requirement of a qualified allocation is that such allocation must have substantial economic effect under section 704(b)(2). Currently, the Service will not rule on the question of whether an allocation has substantial economic effect under section 704(b)(2). Therefore, unless and until this policy is changed, a ruling request regarding a qualified allocation must contain a representation that the subject allocation has substantial economic effect (or complies with A-23, if applicable).

Q-25. Do priority cash distributions which constitute guaranteed payments under section 707(c) disqualify an otherwise qualified allocation?

A-25. Priority cash distributions to partners which constitute guaranteed payments will not disqualify an otherwise qualified allocation if the priority cash distributions are reasonable in amount (*e.g.*, equal to the Federal short-term rate described in section 1274(d)) and are made in equal priorities to all partners in proportion to their capital in the partnership. Other guaranteed payments will be closely scrutinized and, in appropriate cases, will disqualify an otherwise qualified allocation.

Example. A and B form Partnership AB to operate a manufacturing business. A is a tax-exempt entity; B is a taxable person. A contributes $500,000 to the partnership; B contributes $100,000. The partnership agreement provides that A and B are each entitled to cash distributions each year, in equal priority, in an amount equal to 8 percent of their capital contribution. Assume that these payments are reasonable in amount and constitute guaranteed payments under section 707(c). Without taking into consideration the guaranteed payments, all allocations constitute qualified allocations under section 168(j)(9)(B) and A-22. These guaranteed payments will not disqualify such allocations.

Q-26. Can property be treated as tax-exempt use property under both the general rule of section 168(j)(3) and the partnership provisions of section 168(j)(9)?

A-26. Yes. For example, a tax-exempt entity may be a partner in a partnership that owns a building 60 percent of which is tax-exempt use property because it is leased to an unrelated tax-exempt entity under a 25-year lease. The status of the remaining 40 percent depends on whether or not allocations under the partnership agreement are qualified under section 168(j)(9). If the allocations are not qualified under section 168(j)(9), the tax-exempt entity's proportionate share (as determined under section 168(j)(9)(C)) of the remaining 40 percent will be tax-exempt use property. For example, if the tax-exempt entity's proportionate share is 30 percent, then 12 percent of the remaining 40 percent (*i.e.*, .30 times .40) is tax-exempt use property and a total of 72 percent of the property (60 percent + 12 percent) is tax-exempt use property.

Effective date questions:

Q-27. Does an amendment to a lease (or sublease) to a tax-exempt entity of property which, pursuant to the effective date provisions of section 31(g) of TRA, is not subject to section 168(j) cause such property to be subject to the provisions of section 168(j)?

A-27. An amendment to such a lease (or sublease) does not cause such property to be subject to the provisions of section 168(j) unless the amendment increases the term of the lease (or sublease). However, if the amendment increases the amount of property subject to the lease, the additional property must be tested independently under the effective date provisions of section 31(g) of TRA. See A-31 for special rules regarding improvements to property.

Example. On May 1, 1983, X, a taxable entity, and E, a tax-exempt entity, enter into a lease whereby X will lease to E the top 4 floors of a ten-story building for a lease term of 25 years. In 1985, the lease is amended to provide that E will lease an additional floor for the balance of the lease term. At that time the annual rent due under the lease is increased. Pursuant to the provisions of section 31(g)(2)(A) of TRA, section 168(j) does not apply to the lease to E of the top 4 floors of the building. Assuming that no other provision of section 31(g) of TRA provides otherwise, the floor added to the lease in 1985 is subject to the provisions of section 168(j).

Q-28. If property which is not subject to section 168(j) by virtue of the effective date provisions of section 31(g) of TRA is sold, subject to the lease to the tax-exempt entity, what are the consequences?

A-28. Property to which section 168(j) does not apply by virtue of the effective date provisions set forth in section 31(g)(2),(3), and (4) of TRA will not become subject to section 168(j) merely by reason of a transfer of the property subject to the lease by the lessor (or a transfer of the contract to acquire, construct, reconstruct, or rehabilitate the property), so long as the lessee (or party obligated to lease) does not change. For purposes of the preceding sentence, the term "transfer" includes the sale-leaseback by a taxable lessor of its interest in the property, subject to the underlying lease to the tax-exempt entity. However, if property is transferred to a partnership or other pass-through entity after the effective date of section 168(j)(9) (see section 31(g) of TRA), such property is subject to the provisions of section 168(j)(9).

Q-29. Can property which was leased to a tax-exempt entity after May 23, 1983 and acquired by a partnership before October 22, 1983 be tax-exempt use property.

A-29. Yes. Because the property was leased to a tax-exempt entity after May 23, 1983 it may be tax-exempt use property under section 168(j)(3) and section 31(g)(1) of TRA. However, if the partnership included a tax-exempt entity as a partner, section 168(j)(9) wold be inapplicable under section 31(g)(3)(B) of TRA because the partnership acquired the property before October 22, 1983.

Q-30. What is a binding contract for purposes of the transitional rules in section 31(g) of TRA?

A-30. (i) A contract is binding only if it is enforceable under State law against the taxpayer or a predecessor and does not limit damages to a specified amount, as for example, by a liquidated damages provision. A contract that limits damages to an amount equal to at least 5 percent of the total contract price will not be treated as limiting damages for this purpose. In determining whether a contract limits damages, the fact that there may be little or no damages because the contract price does not significantly differ from fair market value will not be taken into account. For example, if a taxpayer entered into an irrevocable contract to purchase an asset for $100 and the contract contained no provision for liquidated damages, the contract is considered binding notwithstanding the fact that the property had a fair market value of $99 and under local law the seller would only recover the difference

in the event the purchaser failed to perform. If the contract provided for a refund of the purchase price in lieu of any damages allowable by law in the event of breach or cancellation, the contract is not considered binding.

(ii) A contract is binding even if subject to a condition, so long as the condition is not within the control of either party or a predecessor in interest. A contract will not be treated as ceasing to be binding merely because the parties make insubstantial changes in its terms or because any term is to be determined by a standard beyond the control of either party. A contract which imposes significant obligations on the taxpayer (or a predecessor) will be treated as binding notwithstanding the fact that insubstantial terms remain to be negotiated by the parties to the contract.

(iii) A binding contract to acquire a component part of a larger piece of property will not be treated as a binding contract to acquire the larger piece of property. For example, if a tax-exempt entity entered into a binding contract on May 1, 1983 to acquire a new aircraft engine, there would be a binding contract to acquire only the engine, not the entire aircraft.

Q-31. If an improvement is made to a property that is "grandfathered" (*i.e.*, property that is not subject to section 168(j) because of the effective date provisions of section 31(g) of TRA), to what extent will such improvement be grandfathered?

A-31. Section 31(g)(20)(B) provides that a "substantial improvement" to property is treated as a separate property for purposes of the effective date provisions of section 31(g) of TRA. As a result, a "substantial improvement" will not be grandfathered unless such "substantial improvement" is grandfathered under a provision other than section 31(g)(20)(B). A property that is grandfathered will not become subject to section 168(j) merely because an improvement is made to such property, regardless of whether the improvement is a "substantial improvement". If an improvement other than a "substantial improvement" is made to property (other than land) that is grandfathered, that improvement also will be grandfathered. The determination of whether new construction constitutes an improvement to property or the creation of a new separate property will be based on all facts and circumstances. Furthermore, any improvement to land will be treated as a separate property.

Example. On January 3, 1983, T, a taxable entity, entered into a lease of a parking lot to E, a tax-exempt entity. On January 1, 1985, T begins construction of a building for use by E on the site of the parking lot. The building is completed and placed in service in November 1985. The building is treated as a separate property, and is thus subject to the provisions of section 168(j), unless the building is grandfathered under a provision other than section 31(g)(20)(B) of TRA.

Q-32. What is "significant official governmental action" for purposes of the section 31(g)(4) transitional rule of TRA?

A-32. (i) "Significant official governmental action" involves three separate requirements. First, the action must be an official action. Second, the action must be specific action with respect to a particular project. Third, the action must be taken by a governmental entity having authority to commit the tax-exempt entity to the project, to provide funds for it, or to approve the project under State or local law.

(ii) The first requirement of official action means that the governing body must adopt a resolution or ordinance, or take similar official action, on or before November 1, 1983. The action qualifies only if it conforms with Federal, State, and local law (as applicable) and is a proper exercise of the powers of the governing body. Moreover, the action must not have been withdrawn. There must be satisfactory written evidence of the action that was in existence on or before November 1, 1983. Satisfactory written evidence includes a formal resolution or ordinance, minutes of meetings, and binding contracts with third parties pursuant to which third parties are to render services in furtherance of the project.

(iii) The second requirement of specific action is directed at the substance of the action taken. The action must be a specific action with respect to a particular project in which the governing body indicates an intent to have the project (or the design work for it) proceed. This requires that a specific project have been formulated and that the significant official action be a step toward consummation of the project. If the action does not relate to a specific project or merely directs that a proposal or recommendation be formulated, it will not qualify. The following set of actions with respect to a particular project constitute specific action: the hiring of bond counsel or bond underwriters necessary to assist in the issuance and sale of bonds to finance a particular project or the adoption of an inducement resolution relating to bonds to be issued for such a project; applying for an Urban Development Action Grant on behalf of the project described in the application, receiving such a grant concerning the project, or the recommendation of a city planning authority to proceed with a project; the enactment of a State law authorizing the sale, lease, or construction of the property; the appropriation of funds for the property or authorization of a feasibility study or a development services contract with respect to it; the approval of financing arrangements by a regulatory agency; the enactment of a State law designed to provide funding for a project; the certification of a building as a historic structure by a State agency and the Department of the Interior; or the endorsement of the application for a certification of need with respect to a medical facility by a regulatory agency other than the agency empowered to issue such a certificate.

(iv) The third requirement for significant official governmental action is that the action must be taken by a Federal, State, or local governing body having authority to commit the tax-exempt entity to the project, to provide funds for it, or to approve the project under applicable law. If the chief executive or another representative of a governing body has such authority, action by such representative would satisfy the requirement of this (iv). A governing body may have the authority to commit the tax-exempt entity to a project notwithstanding the fact that the project cannot be consummated without other governmental action being taken. For example, a city council will be treated as having authority to commit a city to do a sale-leaseback of its city hall notwithstanding the fact that State law needs to be amended to permit such a transaction. Similarly, if a local project cannot be completed without Federal approval, either legislative or administrative, the obtaining of such

approval satisfies the requirements of this (iv).

(v) Routine governmental action at a local level will not qualify as significant official governmental action. Routine governmental action includes the granting of building permits or zoning changes and the issuance of environmental impact statements.

(vi) In order to qualify under the transitional rule of TRA section 31(g)(4), a sale and leaseback pursuant to a binding contract entered into before January 1, 1985 must be part of the project as to which there was significant official governmental action. Except as provided in the following sentence, where there has been significant official governmental action on or before November 1, 1983 with respect to the construction, reconstruction, or rehabilitation of a property, the sale and leaseback of such property pursuant to a binding contract entered into before January 1, 1985 will be treated as part of the project which was the subject of the significant official governmental action. However, if the construction, reconstruction or rehabilitation was substantially completed prior to January 1, 1983, the sale and leaseback of such property will be treated as a separate project, unless the sale and leaseback was contemplated at the time of the significant official governmental action. Nevertheless, where the sale and leaseback is treated as a separate project, section 31(g)(4) may apply if there was significant official governmental action on or before November 1, 1983, with respect to such sale and leaseback. The application of this provision is illustrated by the following example:

Example. In the summer of 1927, the Board of Aldermen of City C passed a resolution authorizing the design and construction of a new city hall and appropriated the funds necessary for such project. Construction was completed in 1928. At the time of the significant official governmental action, City C had no plan to enter into a sale-leaseback arrangement with respect to the facility. On December 15, 1984, City C entered into a binding sale-leaseback arrangement concerning the city hall. This transaction will not qualify for exclusion from section 168(j) under section 31(g)(4) of TRA since construction of the facility in question was substantially completed before January 1, 1983. If, however, there had been significant official governmental action on or before November 1, 1983 with respect to the sale-leaseback project, then the transitional rule of section 31(g)(4) of TRA would apply.

OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT (26 CFR Part 602)

5. The authority citation for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

6. Section 602.101(c) is amended by inserting in the appropriate place in the table "§1.168(f)(8)-1T . . . 1545-0923".

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved June 19, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Register on June 28, 1985, 9:46 a.m., and published in the issue of the Federal Register for July 2, 1985, 50 F.R. 27222)

Section 170.—Charitable, Etc. Contributions and Gifts

26 CFR 1.170A-1: Charitable etc., contributions and gifts, allowance of deduction.

Charitable contribution; valuation; donor-imposed restriction on use. When a donor places a restriction on the use of property, the amount of the charitable contribution deduction is the fair market value of the property at the time of the contribution determined in light of the restriction.

Rev. Rul. 85-99

ISSUE

Under the described conditions, is the amount of a charitable contribution deduction affected by a restriction placed by the donor on the use of the donated property?

FACTS

An agricultural college sought to acquire a certain parcel of land to use in connection with its operations in farming research and development of new farming techniques. The college is an organization described in section 501(c)(3) and 170(c) of the Internal Revenue Code. In 1982, the owner of the property, an individual, gave 50 acres of a 100 acre parcel of land to the college under a deed of gift that carried a restrictive convenant providing that the land be used for agricultural purposes only. The donor retained the remaining 50 acres but retained no interest in the donated property. Use of the land for agricultural purposes would not result in a special benefit to the donor. The highest and best use of the land was for a more valuable use than agricultural purposes.

LAW AND ANALYSIS

Section 170(a) of the Code provides that there shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made in the taxable year.

Section 1.170A-1(c) of the Income Tax Regulations provides that if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution reduced as provided by section 170(e)(1) of the Code and section 1.170A-4(a) of the regulations.

Although the highest and best use of the contributed property, if unencumbered, would be for a more valuable use than as agricultural land, the deed of gift to the land carried a restrictive covenant providing that the land be used solely for agricultural purposes.

The value of property contributed under section 170 is the price that a reasonably knowledgeable willing buyer would pay a reasonably knowledgeable willing seller for the property subject to any restrictions imposed at the time of the contribution. See section 1.170A-1(c) of the regulations. Property otherwise intrinsically more valuable that is encumbered by some restriction or condition limiting its marketability or use, must be valued in the light of such limitation. See *Cooley v. Commissioner*, 33 T.C. 223, 225 (1959), aff'd per curiam, 238 F.2d 945 (2d Cir. 1960); *Deukmejian v. Commissioner*, T.C.M. 1981-24; *Silverman v. Commissioner*, T.C.M. 1968-216; *Klopp v. Commissioner*, T.C.M. 1960-185; *Dresser v. Commissioner*, T.C.M. 1956-54.

HOLDING

Subject to the reductions imposed by section 170(e)(1) of the Code, the amount of the taxpayer donor's charitable contribution deduction is the fair market value of the property at the time

of the contribution determined in the light of the restriction placed by the donor on the use of the property.

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26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.

Charitable contributions; utility bills; emergency energy program. Utility customers, who pay additional amounts on their utility bills to a utility company acting as agent for a charitable organization that assists individuals with emergency energy needs, are entitled to a charitable deduction for the additional amount in the year paid.

Rev. Rul. 85-184

ISSUE

Whether customers who pay additional amounts on their utility bills to a utility company acting as an agent for a charitable organization that assists individuals with emergency energy needs, are allowed a charitable contribution deduction for such added amounts under section 170(a) of the Internal Revenue Code.

FACTS

O, a local chapter of a national charitable organization described in section 170(c) of the Internal Revenue Code, established a program designed to provide financial assistance to elderly and handicapped individuals in meeting their emergency energy related needs. *O* entered into an agreement with *X*, a local utility company, to facilitate the collection of charitable contributions made by customers of *X* and others. Under the agreement, *O* designated *X* as its authorized agent to collect contributions to the program on *O*'s behalf. Customers of *X* are given the opportunity of making contributions to *O*'s financial assistance program for the elderly and handicapped when making payments for utility services. Provided a customer pays his monthly bill in full, an additional amount may be paid to *X* and designated, in a space provided on the bill, as being earmarked for *O*'s financial assistance program. Such earmarked amounts collected by *X* are transferred to *O* on a weekly basis. During the period between receipt of such amounts and their subsequent transfer to *O*, they are segregated from *X*'s own funds. Further, *X* does not exercise any dominion or control over the earmarked funds and does not draw upon them to cover expenses incurred by *X* in connection with the program.

All determinations with respect to a person's eligibility to receive assistance under the program including the existence of an individual's emergency energy related needs are solely within the discretion of *O*.

LAW AND ANALYSIS

Section 170(a) of the Code provides, subject to certain limitations, a deduction for charitable contributions and gifts to or for the use of organizations described in section 170(c), payment of which is made within the taxable year.

Section 1.170A-1(b) of the Income Tax Regulations provides that, ordinarily, a contribution is made at the time delivery is effected.

Rev. Rul. 55-192, 1955-1 C.B. 294, holds that the portion of the membership dues earmarked for distribution to qualified charities and paid by individual members to the treasurer of a social club, acting also as a collecting agent for certain charitable organizations, is deductible under section 170 of the Code for the year in which the contributions are paid to the treasurer.

In the instant case, *X* is acting as *O*'s collection agent in receiving certain amounts in excess of monthly fees billed to *X*'s customers that are earmarked for use by *O*. Further, *X* exercises no dominion and control over such amounts. Therefore, delivery of such amounts to *X* constitutes delivery to *O* for purposes of section 1170 of the Code.

HOLDING

A customer of *X* who makes a contribution under the program by adding an amount to the customer's utility bill will be entitled to a deduction for such amount in the manner and to the extent provided by section 170 of the Code in the taxable year the contribution is paid to *X*. A customer who pays no more than the amount of the utility bill, but nevertheless designates a portion of the payment as being earmarked for *O*'s financial assistance program, will not be entitled to a deduction because *X* does not segregate such amounts and pay them to *O*, but retains the amounts as payment of the customer's utility bill.

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26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.

Increase in the optional standard mileage rate for computing the allowable deduction for the cost of operating an automobile for transportation in connection with rendering gratuitous services to a charitable organization. See Rev. Proc. 85-49, page 716.

Section 174.—Research and Experimental Expenditures

26 CFR 1.174-3: Treatment as expenses. (Also Section 111; 1.111-1.)

Research and experimental expenditures. Research or experimental costs previously deducted pursuant to section 174(a) of the Code are not subject to recapture upon the subsequent sale of the resulting technology. Rev. Rul. 72-528 revoked.

Rev. Rul. 85-186

ISSUE

Whether "tax benefit" recapture as ordinary income of research or experimental expenditures previously deducted pursuant to section 174(a) of the Internal Revenue Code is required upon subsequent sale of the resulting technology.

FACTS

The principal business activity of the taxpayer is the manufacture and sale of consumer products. Since commencing trade or business activity in 1960, the taxpayer has engaged in extensive in-house research and experimental activities directed at the development of patented and unpatented technology to be used in the manufacture of products sold in the ordinary course of taxpayer's trade or business. The taxpayer has consistently deducted all qualifying research or experimental expenditures pursuant to section 174(a) of the Code, and no portion of these deductions failed to effect a reduction of the taxpayer's federal income tax liability. In 1985, the taxpayer decided to discontinue a product line to better conform its product offerings to its marketing strategy. As a result of the decision, the taxpayer sold certain patented and unpatented technology that had resulted from qualifying expenditures properly deducted in prior tax years pursuant to

section 174(a) of the Code.

LAW AND ANALYSIS

Section 174(a) of the Code and section 1.174-3(a) of the Income Tax Regulations provide that a taxpayer may treat research or experimental expenditures that are paid or incurred during the tax year in connection with the taxpayer's trade or business as expenses that are not chargeable to capital account. Section 1.174-2(a)(1) of the regulations provides that the term "research or experimental expenditures" as used in section 174 means expenditures incurred in connection with the taxpayer's trade or business that represent research and development costs in the experimental or laboratory sense.

The tax benefit rule requires the inclusion in income of certain amounts that were deducted in a prior tax year and that generated a tax benefit to the taxpayer through a reduction in the amount of tax liability in the prior tax year. *See generally, Estate of Block v. Commissioner*, 39 B.T.A. 338 (1939), *aff'd sub nom. Union Trust Co. v. Commissioner*, 111 F.2d 60 (7th Cir.), *cert. denied*, 311 U.S. 658 (1940); Rev. Rul. 68-104, 1968-1 C.B. 361. In appropriate circumstances, if a deduction reduces ordinary income in the year the amount is paid or incurred, and if an event in a subsequent taxable year triggers application of the tax benefit doctrine, the amount of the prior deduction will be included in gross income and characterized as ordinary income. *See Merchant National Bank v. Commissioner*, 199 F.2d 657 (5th Cir. 1952). In *Hillsboro National Bank v. Commissioner*, 460 U.S. 370 (1983), 1983-1 C.B. 50, the United States Supreme Court stated that, in order for the tax benefit doctrine to be invoked, an event must occur in a subsequent year that is "fundamentally inconsistent" with the premise or premises on which the prior year deduction was based. The *Hillsboro* standard requires an analysis of whether the prior year deduction would have been allowed if the subsequent year event had occurred in the prior year, considering the purpose and the function of the provision allowing the prior year deduction.

To determine the applicability of the tax benefit doctrine to previously deducted research or experimental expenditures, *Hillsboro* requires a determination of the purpose and the function of the provision permitting the prior year deduction. The legislative history of section 174 of the Code indicates two purposes for enacting section 174(a): (1) to encourage research and experimental activities and (2) to eliminate the uncertainty as to the tax treatment of research or experimental expenditures. H.R. Rep. Ho. 1337, 83rd Cong., 2d Sess. 28 (1954).

To encourage research or experimental activities, section 174(a) permits the deduction of research or experimental expenditures during the tax year such expenditures are paid or incurred. This rule of section 174(a) represents a deviation from the general rules governing the deductibility of expenditures. Under the general rules, expenditures otherwise deductible under section 162 are not deductible to the extent attributable to the acquisition or creation of assets having a useful life extending substantially beyond the tax year. *See* sections 1.263(a)-2(a) and 1.461-1(a) of the regulations. However, section 174(a) allows a current deduction for research or experimental expenditures even though such expenditures may lead to the creation of assets having a useful life that extends substantially beyond the tax year.

To eliminate uncertainty as to the tax treatment of research or experimental expenditures, section 174(a) relieves taxpayers of the obligation, imposed by the rules that ordinarily govern the deductibility of expenditures, to allocate costs between amounts currently deductible and amounts required to be capitalized.

In the present situation, both purposes underlying section 174(a) were accomplished by allowing the taxpayer a current deduction for the research or experimental expenditures paid or incurred. The legislative purpose of encouraging research or experimental activity was accomplished in the year of the deduction because that is the year the research or experimental expenditures were paid or incurred. The legislative purpose of relieving the taxpayer of the obligation to allocate costs between amounts currently deductible and amounts required to be capitalized was accomplished in the year of the deduction because the taxpayer was allowed a deduction in that year for all research or experimental expenditures paid or incurred. It would be inconsistent with this legislative purpose to relieve the taxpayer of the obligation to allocate costs in the year of the deduction only to impose the obligation in the year of disposition of the resulting technology.

Because the two legislative purposes for enacting section 174(a) were accomplished in the year of the deductions, the subsequent sale of the resulting technology had independent significance and was not fundamentally inconsistent with the prior section 174(a) deductions. Accordingly, the tax benefit doctrine as articulated in *Hillsboro* does not apply to the research or experimental expenditures previously deducted by the taxpayer pursuant to section 174(a).

HOLDING

Under the facts set forth above, disposition of the technology resulting from previously deducted section 174(a) expenditures is not fundamentally inconsistent with the prior year deduction of such expenditures. Accordingly, under these facts, the tax benefit doctrine does not apply to the disposition of the resulting technology.

EFFECT ON OTHER RULINGS

Rev. Rul. 72-528, 1972-2 C.B. 481, involves a "pilot model" of a machine that had been constructed for use in the taxpayer's product development program. The taxpayer claimed and was allowed a section 174(a) deduction for the entire amount of the costs incurred on the "pilot model." The "pilot model" was totally destroyed in a succeeding tax year by an explosion and fire, and the taxpayer subsequently was reimbursed by its insurance carrier for the loss suffered. Rev. Rul. 72-528 holds that the tax benefit doctrine applies to the receipt of insurance proceeds. Because the holding of Rev. Rul. 72-528 is inconsistent with the holding of this Revenue Ruling, Rev. Rul. 72-528 is revoked.

Part VII.—Additional Itemized Deductions for Individuals

Section 212.—Expenses for Production of Income

Section 212

26 CFR 1.212-1: Nontrade or nonbusiness expenses.

Whether expenses incurred by an individual that are attributable to the punitive damage portion of the amount the individual received in settlement of a libel suit for injury to personal reputation are deductible as nonbusiness expenses. See Rev. Rul. 85-98, page 51.

Section 213.—Medical, Dental, Etc., Expenses

26 CFR 1.213-1: Medical, dental, etc. expenses.

Standard mileage rate for the cost of operating an automobile in connection with transportation for medical care. See Rev. Proc. 85-49, page 716.

Section 216.—Deduction of Taxes, Interest, and Business Depreciation by Cooperative Housing Corporation Tenant-Stockholder

26 CFR 1.216-1: Amounts representing taxes and interest paid to cooperative housing corporation.

Cooperative housing corporation; housetrailers. The requirements of section 216(b)(10(B) of the Code are satisfied if housetrailers and the land on which they are permanently located are owned by a cooperative housing corporation, the tenant-stockholders are entitled to occupy for dwelling purposes the housetrailers by reason of stock ownership, and the housetrailers contain independent living facilities for one family including permanent provisions for sleeping, eating, cooking, and sanitation.

Rev. Rul. 85-147

FACTS

Situation 1

X corporation purchased a trailer park, consisting of 20 housetrailers and the land on which the housetrailers were permanently located. *X* corporation sold shares of stock to individuals each of whom, by virtue of ownership thereof, was entitled to occupy one of the housetrailers owned by *X* corporation and the land on which the housetrailer is located. Each of the housetrailers contains independent living facilities for one family including permanent provisions for sleeping, eating, cooking, and sanitation.

Situation 2

The facts are the same as in *Situation 1*, except that *X* corporation does not own the 20 housetrailers, but only the land on which the housetrailers are located. The housetrailers are individually owned by stockholders of *X* corporation. Each stockholder is entitled, by reason of stock ownership, to occupy only the land on which the stockholder's housetrailer is located.

LAW AND ANALYSIS

Section 216(b)(1)(B) of the Code defines a cooperative housing corporation, in part, to mean a corporation each of the stockholders of which is entitled, solely by reason of the stockholder's ownership of stock in such corporation, to occupy for dwelling purposes a house, or an apartment in a building, owned or leased by such corporation.

For purposes of section 216(b)(1)(B) of the Code, the term house means a residential unit providing complete, independent living facilities for one family including permanent provisions for sleeping, eating, cooking and sanitation. *See* Rev. Rul. 74-241, 1974-1 C.B. 68, which similarly defines the term apartment for purposes of section 216(b)(1)(B).

Section 1.216-1(d)(2) of the Income Tax Regulations provides that in order for a corporation to qualify as a "cooperative housing corporation," each stockholder of the corporation, whether or not the stockholder qualifies as a tenant-stockholder under section 216(b)(2) of the Code and section 1.216-1(e) of the regulations, must be entitled, to occupy for dwelling purposes an apartment in a building or a unit in a housing development owned or leased by such corporation.

Since the housetrailers have sleeping, eating, cooking, and sanitation facilities in *Situations 1 and 2*, each housetrailer constitutes a house within the meaning of section 216(b)(1)(B) of the Code. Further, the requirements of section 216(b)(1)(B) are satisfied in *Situation 1* because the housetrailers are owned by *X* corporation and each stockholder of *X* corporation is entitled, solely by reason of the stockholder's ownership of stock in *X* corporation, to occupy one of the housetrailers owned by *X* corporation. However, the requirements of section 216(b)(1)(B) are not satisfied in *Situation 2* because *X* corporation does not own the housetrailers that its stockholders occupy. Instead, each stockholder in *Situation 2* is entitled to occupy the housetrailer owned by the stockholder by reason of such ownership and not by reason of the stockholder's ownership of the stock of *X* corporation.

HOLDING

Although each housetrailer in *Situations 1 and 2* constitutes a house within the meaning of section 216(b)(1)(B) of the Code, the requirements of section 216(b)(1)(B) are satisfied only in *Situation 1*, but not in *Situation 2*.

Section 217.—Moving Expenses

26 CFR 1.217-2: Deduction for moving expenses paid or incurred on taxable years beginning after December 31, 1969.

Simplified, optional method that may be used for computing deductions for the costs of operating a passenger automobile for moving expense purposes. See Rev. Proc. 85-49, page 716.

Part VIII.—Special Deductions for Corporations

Section 243.—Dividends Received by Corporations

26 CFR 1.243-4: Qualifying dividends.

Dividends received; affiliated group; reorganization; 100 percent deduction. A cash distribution by a previously unaffiliated corporation to a currently affiliated corporation, subsequent to a transaction qualifying as a mere change in form under section 1.243-4(a)(5)(i)(b) of the regulations, qualifies for the 100 percent dividends-received deduction permitted by section 243 of the Code.

Rev. Rul. 85-144

ISSUE

Does the distribution described below qualify for the 100-percent dividends-received deduction permitted by section 243 of the Internal Revenue Code?

FACTS

X was an unaffiliated corporation that had conducted a business since 1965. The board of directors of *X* determined that a holding company structure would best serve the business activities of *X*. To accomplish this, *X* caused corporation P to be organized. Immediately thereafter, P formed S as its wholly owned subsidiary.

Pursuant to a plan of reorganization and agreement of merger, and before *P* or *S* conducted any business, *S* was merged into *X* under applicable state law. Under the merger agreement, all *X* shares were converted to *P* shares and all *S* shares were converted to *X* shares. Accordingly, the former shareholders of *X* now own all the shares of *P*, and *P* owns all the shares of *X*. The merger of *S* into *X* qualifies as a reorganization within the meaning of section 368(a)(1)(A) of the Code by reason of section 368(a)(2)(E).

After the reorganization and not in connection with it, *X* distributed cash to *P* out of *X*'s earnings and profits that had arisen before the reorganization.

LAW AND ANALYSIS

Section 243(a)(3) of the Code provides that, in the case of a corporation, there shall be allowed as a deduction 100 percent of the amount received as qualifying dividends from a domestic corporation.

Section 243(b)(1) of the Code defines the term "qualifying dividends" to mean dividends received by a corporation while a member of the same affiliated group of corporations as the distributing corporation, if, among other requirements, such dividends are distributed out of earnings and profits of a taxable year of the distributing corporation on each day of which the distributing corporation and the corporation receiving the dividends were members of the same affiliated group.

Section 1.243-4(a)(5)(i)*(b)* of the Income Tax Regulations provides, for purposes of meeting the condition that the distributing corporation and the receiving corporation must have been members of the same affiliated group, that the group in existence during the taxable year out of the earnings and profits of which the dividend is distributed shall not be considered as a different group from that in existence on the day on which the dividend is received merely because a newly organized corporation (the "acquiring corporation") has acquired substantially all of the outstanding stock of the common parent corporation (the "acquired corporation") solely in exchange for stock of such acquiring corporation, and the stockholders (immediately before the acquisition) of the acquired corporation, as a result of owning stock of the acquired corporation, own (immediately after the acquisition) all of the outstanding stock of the acquiring corporation. In such a transaction, the acquiring corporation shall be treated as having been a member of the affiliated group for the entire period during which the acquired corporation was a member of such group.

If *X* were the common parent of an affiliated group, section 1.243-4(a)(5)(i)*(b)* of the regulations would apply because the acquisition described therein would also describe this transaction. Consequently, the dividend from *X* and *P* would qualify for the 100-percent dividends-received deduction of section 243(a)(3) of the Code. *See* Rev. Rul. 72-274, 1972-1 C.B. 97.

The requirement of section 243(b)(1) of the Code that qualifying dividends be distributed out of earnings and profits of a taxable year of the distributing corporation on each day of which such corporation and the recipient corporation were members of the same affiliated group is satisfied, however, whether or not *X* was a single corporation or the parent of an affiliated group because the transaction described above is the practical equivalent of the type of reorganization described in section 1.243-4(a)(5)(i)*(b)* of the regulations. In satisfying the requirement of section 243(b)(1), it is the relationship of *X* and *P* that is determinative.

HOLDING

The distribution from *X* to *P* qualifies for the 100-percent dividends-received deduction permitted by section 243 of the Code.

Part IX.—Items Not Deductible

Section 265.—Expenses and Interest Relating to Tax-Exempt Income

26 CFR 1.265-1: Expenses relating to tax-exempt income.
(Also Sections 107, 163, 164, 7805; 1.107-1, 1.163-1, 1.164-1, 301.7805-1.)

Deductions; expenses and interest relating to tax-exempt income; ministers. Deductions by a minister of the gospel for mortgage interest and real property tax costs will not be disallowed under Rev. Rul. 83-3 if such costs are paid or incurred before January 1, 1987, and if section 1052 of the Tax Reform Act of 1984 would have applied to those costs had they been paid or incurred before January 1, 1986. Rev. Rul. 83-3 modified.

Rev. Rul. 85-96[1]

Rev. Rul. 83-3, 1983-1 C.B. 72, holds, in part, that a minister may not deduct interest and property taxes that are allocable to a rental allowance excluded from gross income under section 107 of the Internal Revenue Code. This holding is based on section 265(1) of the Code, which provides, in part, that no deduction is allowed for any amount that is otherwise deductible but that is allocable to one or more classes of income (other than interest) wholly exempt from income tax. Section 7805(b) of the Code grants the discretion for any revenue ruling to be applied without retroactive effect. Under the authority contained in section 7805(b), Rev. Rul. 83-3 states that if a minister owned and occupied a home before January 3, 1983 (or before January 3, 1983, had a contract to purchase a home and subsequently owns and occupies that home), there will be no disallowance of deductions for interest and property taxes until the earlier of the date on which the minister no longer occupies the home or January 1, 1985.

Section 1052 of the Tax Reform Act of 1984, Pub. L. 98-369, provides that with respect to any mortgage interest or real property tax costs paid or incurred before January 1, 1986, by any minister of the gospel who owned and occupied a home before January 3, 1983 (or had a contract to purchase a home before such date and subsequently owned and occupied such home), the application of section 265(1) of the Code to such costs will be determined without regard to Rev. Rul. 83-3 (and without regard to any other regulation, ruling, or decision reaching the same result, or a result similar to the result, set forth in Rev. Rul. 83-3).

The Internal Revenue Service has decided, under the authority of section 7805(b), to grant further relief to taxpayers who may have relied on Rev. Rul. 62-212, 1962-2 C.B. 41, which was revoked by Rev. Rul. 83-3. Accordingly, deductions for mortgage in-

[1]Also released as New Release IR-85-63, dated July 2, 1985

terest and real property tax costs will not be disallowed under Rev. Rul. 83-3 if such costs are paid or incurred before January 1, 1987, and if section 1052 of the Tax Reform Act of 1984 would have applied to those costs had they been paid or incurred before January 1, 1986.

HOLDING

The second sentence of the next-to-the-last paragraph of Rev. Rul. 83-3 is amended to read as follows:

> Further, if the minister described in *Situation 2* owned and occupied a home before January 3, 1983, (or had a contract to purchase a home before January 3, 1983, and subsequently owns and occupies that home), the revenue ruling will not be applied to that minister so as to disallow deductions for mortgage interest or real property tax costs paid or incurred before January 1, 1987, or before such date as the minister ceases to occupy that home, whichever is earlier.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 83-3 is hereby modified.

Section 274.—Disallowance of Certain Entertainment, Etc., Expenses

26 CFR 1.274-2: Disallowance of deductions for certain expenses for entertainment, amusement, or recreation.

T.D. 8051

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART I—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Disallowance of Deductions for Expenditures Incurred With Respect to Facilities Used in Connection With Entertainment

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the disallowance of deductions for expenditures incurred with respect to facilities, other than clubs, used in connection with entertainment. Changes to the applicable tax law were made by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1] and the Technical Corrections Act of 1979 [Pub. L. 96-222, 1980-1 C.B. 499]. The regulations provide the necessary guidance to the public to comply with the law.

DATES: These regulations are effective after December 31, 1978 and apply to expenses paid or incurred after that date.

FOR FURTHER INFORMATION CONTACT: Stuart G. Wessler of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3297).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) under section 274(a) of the Internal Revenue Code of 1954. These amendments conform the regulations to the amendments made to section 274(a) by section 361 of the Revenue Act of 1978 (92 Stat. 2847) and section 103(a)(10) of the Technical Corrections Act of 1979 (94 Stat. 212). These regulations are to be issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

These final regulations amend paragraphs (a)(2) and (e)(1) of §1.274-2 to deny a deduction for expenditures paid or incurred after December 31, 1978 with respect to a facility, other than a club, used in connection with entertainment. Expenditures paid or incurred with respect to clubs are not affected by the regulations.

On September 26, 1983, proposed regulations were published in the FEDERAL REGISTER (48 FR 43698) [LR-203-78, 1983-2 C.B. 647]. Only one comment was received in response to the proposed regulations.

The proposed regulations provided that dues or fees paid to any social, athletic, or sporting club, although treated as items with respect to facilities, are deductible if certain tests are met. The commenter suggested that the regulations define the term "club" in order to prevent confusion by taxpayers and tax auditors. This suggestion was not adopted in the final regulations. For purposes of these regulations, the term "club" is given its generally understood meaning.

A public hearing was not requested, and therefore, a public hearing was not held. The proposed regulations are adopted without change by the Treasury decision.

REGULATORY FLEXIBILITY ACT

No general notice of proposed rulemaking is required by 5 U.S.C. §553(b) for interpretative regulations. Accordingly, the Regulatory Flexibility Act does not apply and no Regulatory Flexibility Analysis is required for this rule.

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this regulation is not subject to review under Executive Order 12291. Accordingly, a regulatory impact analysis is not required.

DRAFTING INFORMATION

The principal author of these regulations is Donald W. Stevenson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other officers of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, the following amendments are hereby adopted.

Paragraph 1.

Section 1.274-2 is amended by revising paragraph (a)(2), by revising paragraph (a)(3)(iii), by revising the heading of paragraph (e), and by revising paragraph (e)(1). The amended and revised provisions read as follows:

§1.274-2 Disallowance of deductions for certain expenses for entertainment, amusement, or recreation.

(a) *General rules.* * * *

(2) *Entertainment facilities*—(i) *Expenditures paid or incurred after December 31, 1978, and not with respect to a club.* Except as provided in this section with respect to a club, no de-

duction otherwise allowable under hapter 1 of the Code shall be allowed or any expenditure paid or incurred af- er December 31, 1978, with respect to facility used in connection with ntertainment.

(ii) *Expenditures paid or incurred efore January 1, 1979, or with respect o a club.* Except as provided in this ection, no deduction otherwise allowa- le under chapter 1 of the Code shall e allowed for any expenditure paid or ncurred before January 1,1979, with espect to a facility used in connection ith entertainment or at any time with espect to a club used in connection ith entertainment, unless the taxpayer stablishes—

(a) That the facility or club was used rimarily for the furtherance of the tax- ayer's trade or business, and

(b) That the expenditure was directly elated to the active conduct of that rade or business.

The deduction shall not exceed the ortion of the expenditure directly re- ated to the active conduct of the tax- ayer's trade or business.

(3) *Cross references.*

(iii) "Expenditures paid or incurred efore January 1, 1979, with respect ot ntertainment facilities or at any time ith respect to clubs", see paragraph e) of this section, and

* * * * *

(e) *Expenditures paid or incurred efore January 1, 1979, with respect to ntertainment facilities or any time with espect to clubs*—(1) *In general.* Any xpenditure paid or incurred before anuary 1, 1979, with respect to a facil- ty, or paid or incurred at anytime with espect to a club, used in connection ith entertainment shall not be allowed s a deduction except to the extent it neets the requirements of paragraph a)(2)(ii) of this section.

* * * * *

Par. 2 Section 1.274–5(c)(6)(iii) is mended by revising the first two sen- ences thereof to read as follows:

1.274-5 Substantiation requirements.

* * * * *

(c) *Rules for substantiation.* * * *

(6) *Special rules.* * * *

(iii) *Primary use of a facility.* Sec- on 274(a)(1)(B) and (2)(C) denies a eduction for any expenditure paid or ncurred before January 1, 1979, with respect to a facility, or paid or incurred at any time with respect to a club, used in connection with an entertainment activity unless the taxpayer establishes that the facility (including a club) was used primarily for the furtherance of his trade or business. A determination whether a facility before January 1, 1979, or a club at any time was used primarily for the furtherance of the taxpayer's trade or business will depend upon the facts and circumstances of each case. * * *

* * * * *

Par. 3. Section 1.274-6 is revised to read as follows:

§1.274-6 Expenditures deductible without regard to trade or business or other income producing activity.

The provisions of §§1.274-1 through 1.274-5, inclusive, do not apply to any deduction allowable to the taxpayer without regard to its connection with the taxpayer's trade or business or other income producing activity. Examples of such items are interest, taxes such as real property taxes, and casualty losses. Thus, if a taxpayer owned a fishing camp, the taxpayer could still deduct mortgage interest and real property taxes in full even if deductions for its use are not allowable under section 274(a) and §1.274-2. In the case of a taxpayer which is not an individual, the provisions of this section shall be applied as if it were an individual. Thus, if a corporation sustains a casualty loss on an entertainment facility used in its trade or business, it could deduct the loss even though deductions for the use of the facility are not allowable.

Par. 4. Section 1.274-8 is revised to read as follows:

§1.274-8 Effective date.

Except as provided in §1.274-2(a) and (e), §§1.274-1 through 1.274-7 apply with respect to taxable years ending after December 31, 1962, but only in respect of periods after such date.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved August 5, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 6, 1985, 8:45 a.m., and published in the issue of the Federal Register for September 9, 1985, 50 F.R. 36575)

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26 CFR 1.274-5: Substantiation requirements. (Also Section 162; 1.162-17.)

Travel expenses; reimbursement; mileage allowances. With respect to expenses paid or incurred after 1984, mileage allowances not exceeding 21 cents per mile for transportation paid by employers to employees will satisfy the substantiation and adequate accounting requirements of sections 1.162-17(b) and 1.274-5 of the regulations. Rev. Rul. 80-62 as modified by Rev. Ruls. 80-203 and 84-51, is further modified.

Rev. Rul. 85-155[1]

This revenue ruling modifies Rev. Rul. 80-62, 1980-1 C.B. 63, as modified by Rev. Rul. 80-203, 1980-2 C.B. 101 and Rev. Rul. 84-51, 1984-1 C.B. 90, with respect to the mileage allowance for transportation paid by employers to employees.

The sixth paragraph of Rev. Rul. 80-62, which paragraph was modified by Rev. Rul. 80-203 and Rev. Rul. 84-51, is further modified as follows:

If a fixed mileage allowance not exceeding 21 cents a mile is used by an employer in payment of an employee's ordinary and necessary expenses of transportation while traveling away from home, and the elements of time, place, and business purpose of the travel are substantiated in accordance with paragraphs (b)(2) and (c) (other than subparagraph (2)(iii)(a) thereof) of section 1.274-5 of the Income Tax Regulations, such an allowance will be deemed as satisfying, with respect to such travel amounts, the substantiation requirements of section 1.274-5(c) of the regulations and the adequate accounting requirements of section 1.274-5(e). Also, if an employer grants an allowance not exceeding 21 cents a mile to an employee for ordinary and necessary transportation expenses not

[1]Also released as News Release IR-85-95, dated September 19, 1985.

involving travel away from home, such an arrangement will be considered to be an accounting to the employer within the meaning of section 1.162-17(b). However, an employer may grant an additional allowance for the parking fees and tolls attributable to the traveling and transportation expenses as separate items.

This modification is effective with respect to expenses paid or incurred after December 31, 1984.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 80-62, as modified by Rev. Rul. 80-203 and Rev. Rul. 84-51, is further modified.

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26 CFR 1.274-5T: Substantiation with respect to listed property for taxable years beginning after 1984.
(Also Section 132; 1.132-1T.)

T.D. 8060

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Removal of Certain Temporary Regulations on Substantiation and the Taxation of Fringe Benefits

AGENCY: Internal Revenue Service, Treasury.

ACTION: Withdrawal of temporary regulations.

SUMMARY: This document provides a Treasury decision that removes certain temporary regulations contained in T.D. 7986 [1984-2 C.B. 64] and T.D. 8009 [1985-1 C.B. 82], relating to the substantiation requirements of section 274(d), and removes a portion of other temporary regulations contained in T.D. 8009 relating to the taxation of fringe benefits. A change to the applicable tax law was made by Public Law 99-44, Repeal of Contemporaneous Recordkeeping Requirements [page 350, this Bulletin]. This Treasury decision is necessary to respond to the Congressional amendments made by Public Law 94-44.

DATES: The removal of temporary regulations by this Treasury decision is generally effective for taxable years beginning after December 31, 1984.

FOR FURTHER INFORMATION CONTACT: Michel A. Dazé (202-566-3829) or Annette J. Guarisco (202-566-3918) of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224, (Attention: CC:LR:T).

SUPPLEMENTARY INFORMATION:

BACKGROUND

Substantiation

Prior to the Tax Reform Act of 1984 (the 1984 Act) [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1], taxpayers were required under section 274(d) of the Internal Revenue Code of 1954 (the Code) to substantiate by adequate records or sufficient evidence corroborating the taxpayers' own statements any deduction for expenses incurred for (1) travel away from home (including meals and lodging), (2) entertainment, amusement, or recreation activities or the use of a facility in connection with those activities, or (3) business gifts. Before amendment by the 1984 Act, section 274(d) did not apply to vehicles when used in local travel. Instead, the more general substantiation standards under section 162 of the Code were applicable.

Section 179(b) of the 1984 Act amendment section 274(d) to require that any deduction or credit claimed for expenses incurred while traveling away from home, for entertainment, for business gifts, and for "listed property" be substantiated by adequate contemporaneous records. Listed property, as defined in section 280F(d)(4) of the code, generally includes any passenger automobile, any other property used as a means of transportation, any property used for entertainment, recreation, or amusement, and any computer and peripheral equipment.

Temporary and proposed income tax regulations relating to the requirement of section 274(d) (as amended by the 1984 Act) that any deduction or credit with respect to "listed property" be substantiated with "adequate contemporaneous records" were published in the FEDERAL REGISTER for October 24, 1984 (49 FR 42701) [T.D. 7986, 1984-2 C.B. 64]. These temporary regulations were amended in part and supplemented by additional temporary and proposed regulations that were published in the FEDERAL REGISTER for February 20, 1985 (50 FR 7038) [T.D. 8009, 1985-1 C.B. 82] (the February regulations). The February regulations provided certain safe harbors for satisfying the adequate contemporaneous record requirement with respect to the use of vehicles. Adequate contemporaneous records were generally not required if: (1) a vehicle was regularly used directly in connection with a taxpayer's farming business and the taxpayer's income from farming exceeded 70 percent of gross income from all sources ("farming" safe harbor); (2) a vehicle was not used for personal purposes and the vehicle was kept on the employer's premises ("no personal use" safe harbor); (3) the only personal use of an employer-provided vehicle by employees was commuting, the requirements of §1.61-2T were met, and $3.00 per day was included in the income of the employee using the vehicle ("commuting only" safe harbor); or (4) an owner, employer, or employee spent most of a normal business day using a vehicle to make several stops in connection with the owner's or employer's business ("multiple stop" safe harbor). Taxpayers who would have been eligible to use either the "farming" or the "multiple stop" safe harbor could have treated 80 percent of the use of a vehicle designed for commercial purposes, or 70 percent of the use of any other vehicle, as business use without maintaining adequate contemporaneous records. Alternatively, these taxpayers could have kept track of total annual mileage and personal miles driven ("personal miles" safe harbor).

Section 1(a) of Public Law 99-44 (Repeal of Contemporaneous Recordkeeping Requirement) [page 350, this Bulletin] amended section 274(d) and section 1(c) of the same law rescinded any regulations issued to carry out certain of the amendments made by the 1984 Act. This document, therefore, removes the regulatory provisions so issued under section 274(d) as amended by the 1984 Act.

For taxable years beginning in 1985 or before, the recordkeeping requirements of sections 162 and 274(d) apply as in effect before the 1984 Act. Under sectio 274(d), any deduction claimed for (1) expenses incurred while traveling away from home, (2) business-related entertainment expenses, and (3) business-related gifts is disallowed unless substantiated by adequate records or sufficient corroborating evidence. The more general substantiation requirements of section 162 apply to local travel and to listed property, such as a computer, not previously subject to the substantiation requirements of section 274(d). Section 162 requires a taxpayer to prove eligibility for, and the amount of, any deduction claimed for business expenses.

For taxable years beginning after 1985, adequate records or sufficient corroborating evidence are also required to substantiate any deduction or credit claimed for expenses with respect to local travel and listed property. New temporary regulations under section 274 applicable to taxable years beginning after 1985 are published * * *. These regulations will provide taxpayers with guidance for substantiating under section 274(d) any deductions or credits claimed for business expenses.

Fringe benefits

Section 61 of the Code provides that gross income includes "all income from whatever source derived", unless specifically excluded by another provision of the Code. Section 61 also specifies that gross income includes compensation for services. Section 531 of the 1984 Act clarified that fringe benefits are included in income as compensation for services and subject to income and employment taxes. Section 531 also provided an exclusion from gross income for the value of certain fringe benefits (no-additional-cost services, qualified employee discounts, working condition fringes, and de minimis fringes).

Temporary and proposed regulations that provide guidance concerning the taxation of fringe benefits were published in the FEDERAL REGISTER for January 7, 1985 (50 FR 747) [T.D. 8004, 1985-1 C.B. 23] (the January regulations). These regulations provide special rules that may be used to value certain fringe benefits such as the availability of an employer-provided automobile, the use of an employer-provided vehicle for commuting, personal flights on employer-provided airplanes, and taxable flights on commercial airlines. The January regulations also provide guidance concerning income and employment tax withholding and reporting on the value of the benefits. Under these regulations, employers were permitted to deem the value of noncash fringe benefits provided in a calendar quarter as paid no later than the last day of the calendar quarter.

The January regulations were amended in part and supplemented by additional temporary and proposed regulations published in the FEDERAL REGISTER for February 20, 1985 (50 FR 7038) [T.D. 8009, 1985-1 C.B. 82] (the February regulations). The February regulations clarified that the recordkeeping requirements provided in section 274(d) of the Code (and the regulations thereunder) applied to the determination of the amount of a working condition fringe exclusion. The February regulations also provided that recipients of fringe benefits may use the special recordkeeping safe harbors to substantiate the business use of an employer-provided vehicle.

The repeal of the contemporaneous recordkeeping requirement had the effect of also repealing the "farming" and "multiple stop" safe harbors promulgated in the February regulations. Thus, these safe harbor rules are not presently in effect and may not be used to exclude from gross income 70 or 80 percent (whichever would be applicable) of the value of the use of a vehicle without maintaining records. Public Law 99-44 also had the effect of repealing the "personal miles" safe harbor. The commuting-only safe harbor and the nonpersonal use safe harbor, as modified by the Conference Report, are still in effect and may be used to determine the value of the fringe benefit includible in income.

In a letter to Senator Robert Dole, Assistant Secretary of the Treasury Ronald A. Pearlman indicated that the Service will revise the January regulations relating to the valuation of personal flights on employer-provided aircraft (131 Cong. Rec. S6369 (daily ed. May 16, 1985)). The letter set forth safe harbor values that may be used to value personal flights on employer-provided aircraft. The letter also set forth a special rule under which the value of a personal flight taken on an employer-provided aircraft may be deemed to have no value. When 50 percent or more of the regular passenger seating capacity on the aircraft as used by the employer is occupied by individuals whose flights are primarily for the employer's business and whose flights are thus excludable from income, a personal flight by an employee, the employee's spouse, or the employee's dependent children in any of the remaining seats is deemed to have no value. The Treasury Department intends to issue regulations during 1985 that implement the rules outlined in the letter.

Public law 99-44 did not affect general valuation rules or any special valuation rule, such as the Annual Lease Value safe harbor, provided in the January regulations. Many comments were received on these rules, including suggestions that a cents-per-mile formula be used to value the personal use of employer-provided vehicles. Where appropriate, the Service will revise the temporary and proposed regulations when the final regulations are published to take into account comments received.

The January regulations also provide a special valuation rule that, under certain circumstances, may be used to value taxable flights on commercial airlines. The regulations provide that these flights may be valued at 50 percent of the highest unrestricted coach fare available on the flight. Although Public Law 99-44 did not affect this valuation rule, the 50 percent value may be reduced in the revised regulations.

Fringe benefits withholding

Public law 99-44 and the Conference Report that accompanied the law provide new rules for withholding and reporting on taxable noncash fringe benefits. On July 19, 1985, the Service issued a news release and an announcement that provide guidelines on the new rules (*see* Announcement 85-113, 1985-31 I.R.B. 31, August 5, 1985). The Service announced that the

guidelines may be relied upon until the issuance of new regulations.

The announcement provides that employers may treat the value of fringe benefits provided in a calendar year as paid on a pay period, quarterly, semiannual, annual, or other basis provided that the benefits are treated as paid no less frequently than annually. The employer may make a reasonable estimate of the fringe benefits on the date or dates it elects to treat the benefits as paid for purposes of meeting the timely tax deposit requirements. The estimated deposit amount is determined by calculating the amount the employer would be required to deposit had the employer paid cash wages equal to the estimated value of the fringe benefits provided on the date or dates selected and withheld taxes from those cash wages. If the employer underestimates the value of the fringe benefits and thereby makes an underdeposit of the amount required to be deposited (that is, the amount the employer would be required to deposit if the employer had withheld the applicable taxes), the employer may be subject to the failure to deposit penalty. If the employer overestimates the value and deposits more than the amount required, the employer may claim a refund or elect to have the overpayment applied to the employer's next employment tax return.

Under the general income tax and reporting rule, the employer must determine the actual value of the fringe benefits provided in a calendar year by January 31 of the following calendar year. If the benefit is the personal use of a highway motor vehicle, the employer may either determine the actual value for the calendar year or determine the actual value as if the entire usage of the vehicle for the year by the employee is personal (100 percent income inclusion). If the employer includes 100 percent of the value of the vehicle in the employee's income, the employee may calculate the value of his or her business use of the vehicle on Form 2106, Employee Business Expenses, and deduct this amount on Form 1040, Individual Income Tax Return.

For the administrative convenience of employers, a special accounting rule is available as an alternative to the general rule. Under the special accounting rule, the employer may treat the value of the benefits provided during the last two months of the calendar year or any shorter period as paid during the subsequent calendar year. Thus, the employer may treat the value of the benefits provided in the period beginning January 1, 1985, and ending October 31, 1985, as the value of the benefits provided in 1985. For years subsequent to 1985, the value of the benefits actually provided in the last two months of the previous calendar year is treated as provided in the current calendar year together with the value of the benefits provided in the first 10 months of the current calendar year.

Use of the special accounting rule is optional. An employer may use the rule for determining the value of some fringe benefits but not others and the period for which it is used need not be the same for each fringe benefit. However, an employer that uses the rule for a particular benefit must use the rule with respect to all employees who receive that fringe benefit. If the employer uses the special accounting rule, the employee must use the special accounting rule and must use it for the same period as the employer. In addition, since the employee must use the special accounting rule for all purposes, deductions (other than actual out-of-pocket expenses) with respect to a fringe benefit provided in a calendar year are allowable in that calendar year only to the extent that the employer includes the value of the fringe benefit in the employee's income for that calendar year.

Section (3) of Public Law 99-44 provides that an employer may elect not to withhold income taxes on the value of the use of an employer-provided highway motor vehicle provided the employer notifies the affected employee and includes the value of the use of the vehicle on the employee's Form W-2. If the election is to apply to 1985, the employer must notify the affected employee of its decision by September 1, 1985.

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Commissioner of Internal Revenue has determined that this temporary rule is not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis is not required.

REGULATORY FLEXIBILITY ACT

Because no notice of propsed rulemaking is required for this rule, a regulatory flexibility analysis is not required.

DRAFTING INFORMATION

The principal authors of this Treasury decision are Michel A. Dazé and Annette J. Guarisco of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing this Treasury decision, on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 1 and 602 are amended as follows:

PART 1—[AMENDED]

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * Section 1.132-1T also issued under 26 U.S.C. 1322.

Par. 2. The following paragraphs and sections are removed:

1. Section 1.132-1T Q/A-4a
2. Section 1.274-5T
3. Section 1.274-6T

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. Section 602.101(c) is amended by removing from the table "§1.274-5T ... 1545-0074" and "§1.274-6T ... 1545-0074."

This Treasury decision removes the regulations issued to conform to statutory provisions that have been repealed. For this reason, it is found impracticable and unnecessary to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

JAMES I. OWENS,
Commissioner of Internal Revenue.

Approved August 30, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on November 1, 1985, 8:46 a.m., and published in the issue of the Federal Register for November 6, 1985, 50 F.R. 46004)

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26 CFR 1.274-5T: Substantiation requirements (temporary).
(Also Sections 61, 132, 162, 280F; 1.61-2T, 1.132-1T, 1.162-25T, 1.280F-1T.)

T.D. 8061

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Temporary Regulations Relating to the Revised Recordkeeping Requirements With Respect to Listed Property; Taxation of Fringe Benefits

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary income tax regulations relating to the requirement that any deduction or credit with respect to certain business-related expenses be substantiated with adequate records or sufficient evidence corroborating a taxpayer's own statement. This document also amends other temporary income tax regulations relating to the limitations on cost recovery deductions and the investment tax credit for "listed property" and temporary income tax regulations relating to the taxation of fringe benefits. In addition, the text of the temporary regulations set forth in this document serves as the text of proposed regulations for two notices of proposed rulemaking published * * * [on pages 809 and 810, this Bulletin]. This action is necessary to conform the income tax regulations to recent legislation and to provide the public with guidance necessary to comply with the law.

EFFECTIVE DATES: The amendments to §1.61-2T are generally effective with respect to the commuting use of employer-provided vehicles that occurs after December 31, 1985. The amendments to §1.132-1T are generally effective with respect to noncash fringe benefits received after December 31, 1984. The amendments to §1.162-25T, relating to certain deductions with respect to noncash fringe benefits, are effective as of January 1, 1985. The temporary regulations relating to the substantiation requirements of section 274(d) (§§1.274-5T and 1.274-6T) are generally effective for taxable years beginning after December 31, 1985. Section 1.274-5T(d)(2) and (3) applies to taxable years beginning after December 31, 1984. The amendments to the temporary regulations relating to the limitations on the investment tax credit and cost recovery deductions have the following effective dates: §1.280F-3T (d)(3), as amended, applies to listed property placed in service after June 18, 1984, beginning with the first taxable year in which section 274(d) applies to that property; the amendments to §§1.280F-1T and 1.280F-5T are generally effective for passenger automobiles leased after April 2, 1985; the amendment to §1.280F-6T(b)(2)(ii) is effective for vehicles placed in service after December 31, 1985; and the amendment to §1.280F-6T(b)(3) is effective for property placed in service after June 18, 1984.

FOR FURTHER INFORMATION CONTACT: Michel A. Dazé, with respect to the provisions under sections 162, 274, and 280F (202-566-6456), or Annette J. Guarisco, with respect to the taxation of fringe benefits (202-566-3918), of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document adds new temporary regulations to the Income Tax Regulations (26 CFR Part 1) under section 274 of the Internal Revenue Code of 1954 (Code), relating to the substantiation requirements with respect to certain "listed property." Section 179 of the Tax Reform Act of 1984 [Pub. L. 98-369, 1985-3 C.B. (Vol. 1) 1, 221] (the 1984 Act) amended Code section 274 to provide that no deduction or credit shall be allowed with respect to "listed property" (as defined in section 280F(d)(4)), unless the taxpayer substantiated any deduction or credit with "adequate contemporaneous records." Temporary regulations were published in the FEDERAL REGISTER on October 24, 1984, and February 20, 1985 (49 FR 42701 and 50 FR 7038) [T.D. 7986, 1984-2 C.B. 64 and T.D. 8009, 1985-1 C.B. 82], providing guidance for taxpayers affected by the requirement to maintain adequate contemporaneous records for taxable years beginning after December 31, 1984. Section 1 of the Repeal of Contemporaneous Recordkeeping Requirements (the 1985 Act) amended section 274 to provide that any deduction or credit with respect to listed property must be substantiated by adequate records or sufficient corroborative evidence and repealed any regulations issued to carry out the amendments made to section 274 by the 1984 Act. This document provides temporary regulations under section 274 to clarify the types of records that are generally necessary to substantiate any deduction or credit with respect to listed property.

Section 531 of the 1984 Act (98 Stat. 877) [1984-3 C.B. (Vol. 1) 1, 385] made various amendments to Code sections 61, 3121, 3231, 3306, 3401, and 3501 and added new Code sections 132 and 4977, relating to the taxation of fringe benefits. Temporary regulations were published in the FEDERAL REGISTER on January 7, 1985 (50 FR 747) [T.D. 8004, 1985-1 C.B. 23] to provide guidance on the treatment of taxable and nontaxable fringe benefits, including the valuation of taxable fringe benefits for purposes of income and employment tax withholding. Where necessary, to clarify the interaction between the section 274 substantiation requirements and the section 132 regulations, these regulations were amended in the FEDERAL REGISTER on February 20, 1985 (50 FR 7038). To reflect the changes made by the 1985 Act to section 274 and the effect on the section 132 regulations, this document amends those temporary regulations.

Section 179 of the 1984 Act also

added a new Code section 280F to provide limitations on the investment tax credit and depreciation with respect to "listed property" when such property is used for both business and personal purposes. "Listed property" includes a passenger automobile or any other property used as a means of transportation. The 1985 Act amended section 280F to lower the limitations on the amount of the investment tax credit and annual cost recovery deductions allowable for passenger automobiles placed in service after April 2, 1985. This document amends the temporary regulations under section 280F, which were also published in the FEDERAL REGISTER on October 24, 1984 (49 FR 42701).

The temporary regulations contained in this document relating to both substantiation and the taxation of fringe benefits serve as the text of proposed regulations for two notices of proposed rulemaking published * * * [on pages 809 and 810, this Bulletin].

EXPLANATION OF PROVISIONS

SUBSTANTIATION REQUIREMENTS

Introduction

As enacted in 1962, section 274(d) required a taxpayer to substantiate any deduction claimed for certain ordinary and necessary business expenses with adequate records or sufficient evidence corroborating the taxpayer's own statement. The three categories of expenses subject to these substantiation requirements are expenses incurred (1) while traveling away from home, including meals and lodging, (2) for entertainment, amusement, or recreation activities or the use of a facility in connection with those activities, or (3) for business-related gifts. Section 274(d) provides that a deduction for the expenses listed above is disallowed unless substantiated by adequate records or sufficient corroborative evidence.

Regulations under section 274(d) were first issued in 1962 (*see* §1.274-5). Under those regulations, a taxpayer was required to prove certain elements of an expenditure, for example, the amount, time, place, and business purpose of an expenditure for travel away from home. The regulations also described the types of evidence that constitute an adequate record or that may be corroborative of each element of an expenditure. To minimize duplication of records, the regulations provided special rules for certain employees who adequately account to their employers for expenses incurred in the employer's behalf, or independent contractors who adequately account to clients for reimbursements or expense allowances.

After amendment by the 1984 Act and the 1985 Act, section 274(d) disallows any deduction or credit claimed for the expenses listed above and for expenses incurred with respect to "listed property" unless substantiated by adequate records or sufficient corroborative evidence. Listed property, as defined in Code section 280F(d)(4), generally includes any passenger automobile, any other property used as a means of transportation, any property used for entertainment, recreation, or amusement, and any computer and peripheral equipment.

Existing §1.274-5 of the income tax regulations serves as the basis for the temporary regulations under section 274(d) that are contained in this Treasury decision. The temporary regulations contain additional provisions to reflect the application of section 274(d) to deductions or credits claimed with respect to listed property, and the exemption from the requirements of section 274(d) for "qualified nonpersonal use vehicles" under section 274(i).

Application to listed property

As set forth in §1.274-5T(b)(6), the elements of an expenditure with respect to listed property that a taxpayer must prove are (i) the amount, (ii) the date, and (iii) the business purpose of an expenditure or use. The amount of an expenditure may be the cost of acquisition (i.e., the basis of the property), a lease payment, the cost of maintenance and repairs, or the cost of capital improvements. The amount of use is the ratio of business use to total use of the property for a period of time, determined on the basis of mileage for automobiles and other vehicles and time for other listed property.

Section 274(d) contemplates that a taxpayer will maintain and produce records or other evidence that will constitute proof of the elements of an expenditure or use. As explained in §1.274-5T(c)(1), written evidence has more probative value than oral evidence alone, and the value of written evidence is greater the closer in time it relates to the expenditure or use. A contemporaneous log is not required by the temporary regulations, but a record of the elements of an expenditure or of a business use made at or near the time of the expenditure or use when there is generally accurate recall would constitute the best evidence to satisfy the substantiation requirements of section 274(d).

A taxpayer may satisfy the adequate records requirement by maintaining an account book, diary, log, statement of expense, trip sheets, or similar record prepared at or near the time of an expenditure or use, and documentary evidence which, in combination, are sufficient to establish each element of an expenditure. Information in an account book, etc. need not duplicate information contained in documentary evidence, such as a receipt, as long as the two forms of evidence complement each other in an orderly manner. The information required must be recorded at or near the time of the expenditure or use when the taxpayer has full present knowledge of each element of the expenditure or use. For example, a taxpayer may substantiate the business use of an automobile for a period with a journal in which the taxpayer records at the end of each week each element of the business uses of the automobile during the week.

The temporary regulations provide that the level of detail required in an adequate record to establish the element of the business use of property may vary depending on the facts and circumstances. If the taxpayer's use of property follows a regular pattern, the taxpayer may not need to record as much information as would be required if business use were sporadic. *See* §1.274-5T(c)(2)(ii) for an example.

If a taxpayer fails to maintain an adequate record, then the taxpayer must establish the elements of an expenditure or use by a written or oral statement and other corroborative evidence sufficient to establish the elements. For example, a taxpayer may maintain an adequate record for portions of a taxable year and use that record to substantiate

the business/investment use of listed property if the taxpayer can demonstrate by other evidence that the periods for which the adequate record is maintained are representative of the taxable year. *See* §1.274-5T(c)(3)(ii).

Generally, a taxpayer must substantiate the elements of each separate expenditure or use to which section 274(d) applies. However, the taxpayer may substantiate concurrent or repetitious expenditures or uses as a single item in certain cases. As provided in §1.274-5T(c)(6)(i)(B), amounts expended in connection with the use of listed property, such as for gasoline or repairs for an automobile, may be aggregated. If these expenses are aggregated, the taxpayer need not prove the business purpose of each expense, but may prorate the expenses based on the total business use of the property. Similarly, a taxpayer may consider a round trip or an uninterrupted period of business use as a single use (*see* §1.274-5T(c)(6)(i)(C)).

Tax return information

As required by the conference report to the 1985 Act (H.R. Rep. No. 99-67, 99th Cong., 1st Sess. 10 (1985)) [page 359, this Bulletin], §1.274-5T(d)(2) and (3) of the temporary regulations provides that taxpayers must include certain information on their tax returns about the business use of vehicles and other listed property. On returns for taxable years beginning after December 31, 1984, taxpayers that claim a deduction or credit with respect to any vehicle are required to provide the date that the vehicle was placed in service, information about the number of miles driven for various purposes, the percent of business use, whether evidence to support the business use is available, and whether that evidence is written. It is expected that an employer who provides the use of a vehicle to an employee will obtain information from the employee sufficient to complete the employer's tax return. As provided by §1.274-5T(d)(2)(ii), however, certain employers need not include all the information collected from employees on their tax returns and other employers need not obtain any information from employees. With respect to other types of listed property, taxpayers are required to provide the date that the property was placed in service, the percent of business use, whether evidence is available to support the amount of business use, and whether that evidence is written.

Listed property provided to employees

Section 1.274-5T(e) provides new rules for the substantiation of the business use of listed property made available by an employer for use by an employee. Generally, an employee may not exclude from gross income as a working condition fringe any amount of the value of the availability of listed property provided by an employer to the employee, unless the employee substantiates for the period of availability the amount of the exclusion with adequate records or sufficient corroborative evidence. If the employer provides the use of a vehicle to an employee and includes the value of the availability of the vehicle in the employee's gross income without taking into account any exclusion for a working condition fringe, the employee must substantiate any deduction claimed for the business use of the vehicle with adequate records or sufficient corroborative evidence.

An employer substantiates its business use of listed property provided to employees by showing either (1) that, based on adequate records maintained by the employees or on other evidence corroborating the employees' statements, all or a portion of the use of the listed property is by employees in the employer's trade or business, and that if any employee used the property for personal purposes, the employer included an appropriate amount in the employee's income, or (2) in the case of an employer-provided automobile, that the employer treats all use by employees as personal use and includes an appropriate amount in the employees' incomes.

For purposes of substantiating the business use of employer-provided listed property under §1.274-5T(e), an employer may rely on adequate records maintained by its employee or on the employee's own statement if corroborated by other sufficient evidence unless the employer knows or has reason to know that they are not accurate. Alternatively, the employer may rely on a statement submitted by the employee that provides sufficient information to allow the employer to determine the business use of the property unless the employer knows or has reason to know that the statement is not based on adequate records or sufficient corroborative evidence.

Employee business expenses

The provisions of §1.274-5T(f) of the temporary regulations are derived from existing §1.274-5(e) with only minor amendments. Section 1.274-5T(f) applies to employees who are reimbursed for deductible business expenses that they incur in connection with the performance of services as employees. If the employee makes an adequate accounting (*i.e.*, provides adequate records) to the employer of the expenses incurred and receives reimbursements equal to the expenses, the employee need not report either the reimbursements or the expenses on a tax return. If the amount of the reimbursements exceeds the amount of deductible expenses incurred by the employee, the employee must include the excess in income. If the employee's deductible expenses exceed any reimbursement received from the employer, the employee must be able to substantiate any deduction for the excess in accordance with the requirements of section 274(d).

An employee who is not required to make an adequate accounting to the employer, or who is required and fails to do so, must submit, as part of his tax return, the appropriate form issued by the Internal Revenue Service for claiming deductions for employee business expenses (for 1985, Form 2106) and provide the information requested on that form. In addition, the employee must be able to substantiate any deduction for business expenses in accordance with the requirements of section 274(d).

Any employee, whether required to make an adequate accounting to the employer or not, who claims any deduction or credit with respect to listed property, must submit the appropriate form issued by the Internal Revenue Service to provide the necessary information about the use of that property, as discussed above.

Reimbursement arrangements and mileage allowances

Under §1.274-5T(g) of the temporary regulations, which is similar to existing §1.274-5(f), the Commissioner is authorized to prescribe rules under which reimbursement arrangements or per diem allowances covering ordinary and necessary expenses of traveling away from home, or mileage allowances providing for ordinary and necessary expenses of local travel or transportation while traveling away from home, will be regarded as equivalent to substantiation by adequate records or other sufficient evidence. (*See*, for example, Rev. Rul 80-62, 1980-1 C.B. 63, as modified by Rev. Rul. 80-203, 1980-2 C.B. 101, Rev. Rul. 84-51, 1984-1 C.B. 90, and Rev. Rul. 85-155, page 89, this Bulletin.) A mileage allowance for use of a vehicle may be paid to the owner of the vehicle.

For example, an employer may pay an employee a fixed mileage allowance for use of the employee's own automobile in connection with the employer's trade or business. If a fixed mileage allowance not exceeding the prescribed standard mileage rate (*see* Rev. Proc. 85-49, page 716, this Bulletin) is used in payment of an employee's ordinary and necessary expenses of transportation, whether for travel away from home or local travel, and the elements of time, place, and business purpose are substantiated in accordance with the requirements of section 274(d), the mileage allowance is deemed to substantiate the amount of the transportation expenses.

Rev. Rul. 84-127, 1984-2 C.B. 246, provides that an employer is not required to report as wages on Form W-2 reimbursements of amounts equal to or less than the standard mileage rate, but is required to report amounts of reimbursement to an employee exceeding that rate. In theory, the reimbursement equal to or less than the standard mileage rate would be for otherwise deductible expenses incurred by the employee and need not be reported as income. Because the standard mileage rate includes a component for depreciation, the limitations on the investment tax credit and cost recovery deductions imposed by section 280F(d)(3) and §1.280F-6T(a) affect the holding of Rev. Rul. 84-127.

Under §1.280F-6T(a)(1), employee use of the employee's own automobile (or other listed property) in connection with the employer's trade or business is not treated as business use for purposes of determining the amount of any investment credit or cost recovery deduction unless the use is for the convenience of the employer and required as a condition of employment. Whether use of an employee's own automobile is for the convenience of the employer and required as a condition of employment is determined by applying the same principles for determining whether the value of any meals or lodging furnished by an employer to an employee are excluded under section 119 from the employee's gross income. If either requirement is not met and the employee has no other business use of the automobile, the employee is not entitled to any investment credit or cost recovery deduction with respect to that automobile. Under those circumstances, a reimbursement for transportation expenses at the standard mileage rate would exceed the employee's deductible expenses by the amount of the depreciation component. The reimbursement, therefore, must be reported by the employer as income on Form W-2.

Business expenses of independent contractors

Similar to existing §1.274-5(g), §1.274-5T(h) provides rules for the reporting and substantiation of certain expenses for travel, entertainment, gifts, or with respect to listed property paid or incurred by an independent contractor in connection with services performed for a client or customer under a reimbursement or other expense allowance arrangement. Unless an independent contractor substantiates each element of an expenditure in accordance with the requirements of section 274(d) or makes an adequate accounting of that expenditure to a client or customer, the independent contractor must include any reimbursement for that expenditure in income. If the independent contractor accounts to the client or customer for any expenses with adequate records or other sufficient evidence, the client or customer must be prepared to substantiate each element of the expenditure as required by section 274(d).

Qualified nonpersonal use vehicles

Section 2 of the 1985 Act also amended section 274(d) to provide that the substantiation requirements of that section do not apply to any qualified nonpersonal use vehicle. As defined in section 274(i), a qualified nonpersonal use vehicle is any vehicle which, by reason of its nature, is not likely to be used more than a de minimis amount for personal purposes. Section 1.274-5T(k) of the temporary regulations contains a list of these vehicles to which section 274(d) does not apply. Under §1.274-5T(k)(2)(ii)(S), the Commissioner may rule that other vehicles are qualified nonpersonal use vehicles. Comments are, therefore, invited concerning other vehicles that may be designated as qualified nonpersonal use vehicles.

Business use of automobiles and certain other vehicles

A taxpayer whose use of an automobile or certain other vehicles meets certain requirements during a taxable year or shorter period may use, for the relevant period, one of the methods prescribed in §1.274-6T to satisfy the substantiation requirements of section 274(d). Two types of written policy statements, in conjunction with other evidence, if initiated and kept by an employer to implement a policy of no personal use, or no personal use except for commuting, of a vehicle provided by the employer to an employee, may qualify as sufficient evidence corroborating the employer's or employee's own statement regarding the amount of business use of that vehicle. Methods of satisfying the substantiation requirements are also provided for vehicles used in connection with the business of farming and for automobiles provided to employees by employers who treat all use by the employees as personal use. For taxable years beginning in 1985, the methods prescribed in §1.274-6T will also satisfy the requirements of section 162.

As provided in §1.274-6T(b), for a vehicle used in connection with the business of farming, an employer may determine any deduction or credit with respect to the vehicle as if the amount of business use were 75 percent plus that percentage attributable to an amount included in an employee's income to reflect any personal use of the vehicle by the employee. Unlike the

special rule for farm vehicles contained in the repealed temporary regulations that were published in the FEDERAL REGISTER for Feburary 20, 1985, §1.274–6T(b) does not provide separate percentages of business uses for vehicles designed for commercial use and for other vehicles. Only one percentage is considered appropriate because section 274(i) exempts most vehicles designed for commercial use from the section 274(d) substantiation requirements.

TEMPORARY REGULATIONS UNDER SECTION 280F

As added to the Code by the 1984 Act and amended by the 1985 Act, section 280F generally imposes limitations on the amount of investment tax credit and annual depreciation deductions allowed for an automobile placed in service or leased after June 18, 1984. Section 280F also requires the Internal Revenue Service to issue regulations that impose on lessees of passenger automobiles limitations "substantially equivalent" to the limitations imposed on similarly situated owners of passenger automobiles. On October 19, 1984, pursuant to this requirement, the Service issued §1.28F-5T of the temporary regulations. The 1985 Act further limits the amount of investment tax credit and annual depreciation deductions allowable for passenger automobiles placed in service after April 2, 1985.

Limitations applicable to automobiles leased after April 2, 1985, were issued on August 20, 1985, in Announcement 85-127 (also published in 1985-35 I.R.B. 40, September 3, 1985). Section 1.280F-5T of the temporary regulations is amended to incorporate the provisions of that announcement. An error in paragraph (d)(2) of the announcement is also corrected: §1.280F-5T(e)(5)(ii) clarifies that, for any passenger automobile that has a fair market value greater than $32,400, the limitation in the form of an income inclusion in the seventh and subsequent taxable year during which the automobile is leased is only six percent of the amount prescribed by the announcement. One comment on the temporary regulations issued in October, 1984, was that the limitations applicable to leased automobiles did not account for situations when a lessor elects under section 48(d) to treat the lessee as having acquired the automobile allowing the lessee to claim the investment credit. The Internal Revenue Service plans to issue an announcement in the near future that will provide a separate set of limitations applicable to lessees to whom lessors have passed through the investment credit.

Additionally, as issued on October 19, 1984, §1.280F-6T(b)(3) provided that one category of listed property, property of a type generally used for purposes of entertainment, recreation, or amusement, includes photographic, phonographic, communication, and video recording equipment. That section is amended to exclude that equipment in general from the definition of listed property if it is used exclusively at a regular business establishment or in connection with a taxpayer's principal trade or business. If any equipment is not listed property, it is not subject to the substantiation requirements imposed by section 274(d)(4).

FRINGE BENEFITS

Section 61 of the Code provides that gross income includes "all income from whatever source derived," unless specifically excluded by another provision of the Code. In addition, section 61 specifies that gross income includes compensation for services. Section 531 of the 1984 Act clarified that fringe benefits are included in gross income as compensation for services and subject to income and employment taxes. Section 531 also provided an exclusion from gross income for the value of certain fringe benefits (such as no-additional-cost services, qualified employee discounts, working condition fringes, and de minimis fringes).

The temporary regulations under section 61 contain a special rule that may be used to value the commuting use of an employer-provided vehicle. As issued in January 1985, the temporary regulations provided that the special rule could not be used to value the commuting use of an employer-provided vehicle by an officer or five-percent owner of the employer. In February 1985, this restriction was amended to provide that the special rule could not be used to value commuting use (that occurs after March 22, 1985) by an officer or one-percent owner of the employer. This document simplifies the temporary regulations to provide that, for any commuting use that occurs during 1985, the special rule may not be used to value the commuting use of an employer-provided vehicle by an officer or five-percent owner of the employer.

For commuting use occurring after December 31, 1985, the temporary regulations provide that the special rule may not be used to value the commuting use of an employer-provided vehicle by a control employee. However, if a control employee is provided the commuting use of an employer-provided vehicle that is not an automobile (as defined in the regulations), the control employee may use the special rule. The regulations define a control employee separately for government and non-government employers. The Service and Treasury are interested in comments concerning the definition of control employee, especially the treatment of state and local executive officers as control employees. The definition of control employee prescribed for purposes of valuing the commuting use of an employer-provided vehicle will not apply to the valuation of flights on employer-provided aircraft.

The temporary regulations under section 132 clarify the relationship between the section 274 substantiation requirements and a section 132 working condition fringe. The regulations provide that neither an employer nor an employee may exclude the value of property or services from an employee's income as a working condition fringe unless the substantiation requirements of either section 162 or 274 (whichever is applicable) are satisfied. In addition, the section 132 regulations provide that the special substantiation safe harbor rules provided in §1.274-6T may be used by both employers and employees.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this temporary rule is not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis is not required.

A notice of proposed rulemaking is not required by 5 U.S.C. 553(d) for temporary regulations. Accordingly, the temporary regulations do not constitute regulations subject to the Regula-

tory Flexibility Act (5 U.S.C. Chapter 6).

The collection of information requirements contained in these regulations have been submitted to the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal authors of these temporary regulations are Michel A. Dazé and Annette J. Guarisco of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from the other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—[AMENDED]

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C 7805. * * * Section 1.132-1T also issued under 26 U.S.C. 132; section 1.280F-5T also issued under 26 U.S.C. 280F(c).

Par. 2. Section 1.61-2T is amended by removing the heading immediately preceding Q/A-20, Q/A-20, and Q/A-21.

Par. 3. Section 1.61-2T is amended by adding a new heading immediately preceding Q/A-20, new Q/A-20, Q/A-20a, Q/A-20b, and Q/A-21 immediately after Q/A-19 to read as follows:

§1.61-2T Questions and answers relating to the taxation of fringe benefits (temporary).

* * * * *

Use of Employer-Provided Vehicles for Commuting

Q-20: Is there a special rule that taxpayers may use to value employer-provided vehicles which are not available for personal purposes other than commuting?

A-20: A special rule may be used to compute commuting value if the following criteria are met by employers and employees with respect to an employer-provided vehicle:

(a) The vehicle is owned or leased by the employer and is provided to one or more employees for use in connection with the employer's trade or business and is used in the employer's trade or business,

(b) For bona fide noncompensatory business reasons, the employer requires the employee to commute to and/or from work in the vehicle,

(c) The employer has established a written policy under which neither the employee, nor any individual whose use would be taxable to the employee, may use the vehicle for personal purposes, other than for commuting or de minimis personal use (such as a stop for a personal errand on the way between a business delivery and the employee's home),

(d) Except for de minimis personal use, neither the employee nor any individual whose use would be taxable to the employee uses the vehicle for any personal purpose other than commuting, and

(e) The employee required to use the vehicle for commuting is not a control employee of the employer (as defined in Q/A-20b of this section).

If the vehicle is a chauffeur-driven vehicle, the special rule of this Q/A-20 may not be used to value the commuting use of any passenger who commutes in the vehicle. The rule may be used, however, to value the commuting use of the chauffeur. For purposes of Q/A-20 through Q/A-22 of this section, the term "vehicle" means any motorized wheeled vehicle manufactured primarily for use on public streets, roads, and highways. Except as otherwise provided in Q/A-20a and Q/A-20b of this section, the term "vehicle" includes an automobile as defined in Q/A-11 of this section. For purposes of this section, the term "personal use" has the same meaning as prescribed in §1.274-6T(e)(5).

Q-20a: What special effective dates apply to the criteria provided in Q/A-20 of this section?

A-20a: Notwithstanding anything in Q/A-20 of this section to the contrary—

(a) *Written policy not required in 1985.* The policy described in Q/A-20(c) of this section prohibiting personal use need not be written provided the commuting use being valued under the special rule occurs prior to January 1, 1986; and

(b) *Commuting during 1985.* For commuting use that occurs after December 31, 1984, but before January 1, 1986, Q/A-20(e) of this section shall be applied by substituting "an employee who is an officer or a five-percent owner of the employer" in lieu of "control employee." If the vehicle in which the employee is required to commute is not an automobile as defined in Q/A-11 of this section, neither the restrictions of Q/A-20(e) of this section (relating to control employees) nor the restrictions of this Q/A-20a(b) (relating to officers and five-percent owners) apply. For purposes of determining who is a five-percent owner, any individual who owns (or is considered as owning) five or more percent of the fair market value of an entity (the "owned entity") is considered a five-percent owner of all entities which would be aggregated with the owned entity under the rules of section 414(b), (c), or (m).

Q-20b: Who is a "control employee" for purposes of determining the value of the availability of an employer-provided vehicle for commuting?

A-20b: (a) *Non-government employer.* For purposes of Q/A-20 of this section, a control employee of a non-government employer is any employee—

(1) Who is a Board- or shareholder-appointed, confirmed, or elected officer of the employer,

(2) Who is a director of the employer, or

(3) Who owns a one-percent or greater equity, capital, or profits interest in the employer.

For purposes of determining who is a one-percent owner under paragraph (a)(3) of this Q/A-20b, any individual who owns (or is considered as owning under section 318(a) or principles similar to section 318(a) for entities other than corporations) one percent or more of the fair market value of an entity (the "owned entity") is considered a one-percent owner of all entities which would be aggregated with the owned entity under the rules of section 414(b), (c), (m), or (o).

(b) *Government employer.* For purposes of Q/A-20 of this section, a control employee of a government employer is any—

(1) Elected official,

(2) Federal employee who is appointed by the President and confirmed by the Senate, or

(3) State or local executive officer comparable to individuals described in paragraph (b)(1) and (2) of this Q/A-20b.

For purposes of this Q/A-20b, the term "government" includes any Federal, state, or local governmental unit, and any agency or instrumentality thereof.

(c) *Control employee exception.* Notwithstanding anything in this section to the contrary, an employee who is a control employee may use the special valuation rule of Q/A-20 of this section if the criteria of Q/A-20 are satisfied (except for the condition in Q/A-20(e) of this section) and the vehicle in which the control employee is required to commute is not an automobile as defined in Q/A-11 of this section.

Q-21: If the requirements of Q/A-20 of this section are satisfied, what is the special rule for valuing the commuting use of an employer-provided vehicle?

A-21: Under the special rule, the commuting use is valued at $1.50 per one-way commute (e.g., from home to work or from work to home). If there is more than one employee who commutes in the vehicle, such as in the case of an employer-sponsored car pool, the amount includible in the income of each such employee is $1.50 per one-way commute. Thus, the amount includible for each round-trip commute is $3.00 per employee.

Par. 4. Section 1.132-1T is amended by adding new Q/A-4a and Q/A-4b immediately after Q/A-4 to read as follows:

§1.132-1T Questions and answers relating to the exclusion from gross income of certain fringe benefits (temporary).

* * * * *

Working Condition Fringe

* * * * *

Q-4a: Do section 162 and section 274(d) and the regulations thereunder apply in determining the amount, if any, of an employee's working condition fringe with respect to employer-provided property or services?

A-4a: Yes, as provided below.

(a) *In general.* The value of property or services provided to an employee by an employer may not be excluded from the employee's gross income as a working condition fringe, by either the employer or the employee, unless the substantiation requirements of either section 162 or section 274(d) (whichever is applicable) and the regulations thereunder are satisfied.

(b) *Listed property.* With respect to listed property (as defined in section 280F(d)(4)), the substantiation requirements of section 274(d) and the regulations thereunder do not apply to the determination of an employee's working condition fringe exclusion prior to the first taxable year of the employer beginning in 1986. For example, if an employer's first taxable year beginning in 1986 begins on July 1, the substantiation requirements of section 274(d) apply to the employee as of that date. The substantiation requirements of section 274(d) apply generally to an employee regardless of whether the requirements of section 274 apply to the employee's employer (such as when the employer is a tax-exempt organization); in these cases, the requirements of section 274(d) apply to the employee as of January 1, 1986.

In general, the substantiation requirements of section 274(d) are satisfied by adequate records or sufficient evidence corroborating the employee's own statement. Thus, such records or evidence provided by the employee, and relied upon by the employer to the extent permitted by the regulations promulgated under section 274(d), will be sufficient to substantiate a working condition fringe exclusion.

(c) *Safe harbor rules.* Section 1.274-6T provides that the substantiation requirements of section 274(d) and the regulations thereunder may be satisfied, in certain circumstances, by using one or more of the safe harbor rules prescribed in §1.274-6T. If the employer uses one of the safe harbor rules prescribed in §1.274-6T during a period with respect to a vehicle (as defined in §1.61-2T Q/A-20), that rule must be used by the employer to substantiate a working condition fringe exclusion with respect to that vehicle during the period. An employer that is exempt from Federal income tax may still use one of the safe harbor rules (if the requirements of that section are otherwise met during a period) to substantiate a working condition fringe exclusion with respect to the same vehicle during the period. If the employer uses one of the methods prescribed in §1.274-6T during a period with respect to an employer-provided vehicle, that method may be used by an employee to substantiate a working condition fringe exclusion with respect to the same vehicle during the period, as long as the employee includes in gross income the amount allocated to the employee pursuant to §1.274-6T and this section. If, however, the employer uses the same harbor rule prescribed in §1.274-6T(a)(2) or (3) and the employee without the employer's knowledge uses the vehicle for purposes other than de minimis personal use (in the case of the rule prescribed in §1.274-6T(a)(2)), or for purposes other than de minimis personal use and commuting (in the case of the rule prescribed in §1.274-6T(a)(3)), then the employee has additional gross income.

The rules prescribed in this Q/A-4a assume that the safe harbor rules prescribed in §1.274-6T are used for a one-year period. Accordingly, references to the value of the availability of a vehicle, amounts excluded as a working condition fringe, etc., are based on a one-year period. If the safe harbor rules prescribed in §1.274-6T are used for a period of less than a year, the amounts referenced in the previous sentence must be adjusted accordingly. For purposes of this section, the term "personal use" has the same meaning as prescribed in §1.274-6T(e)(5).

(d) *vehicles not available to employees for personal use.* For a vehicle described in §1.274-6T(a)(2) (relating to certain vehicles not used for personal purposes), the working condition fringe exclusion is equal to the value of the availability of the vehicle if the employer uses the method prescribed in §1.274-6T(a)(2).

(e) *Vehicles not available to employees for personal use other than commuting.* For a vehicle described in §1.274-6T(a)(3) (relating to certain vehicles not used for personal purposes

other than commuting), the working condition fringe exclusion is equal to the value of the availability of the vehicle for purposes other than commuting if the employer uses the method prescribed in §1.274-6T(a)(3). The rule applies only if the special rule for valuing commuting use, as prescribed in Q/A-20 through Q/A-22 of §1.61-2T, is used and the amount determined under the special rule is included in the employee's income (or the employee reimburses the employer for such amount).

(f) *Vehicles used in connection with the business of farming that are available to employees for personal use.* For a vehicle described in §1.274-6T(b) (relating to certain vehicles used in connection with the business of farming), the working condition fringe exclusion is calculated by multiplying the value of the availability of the vehicle by 75 percent.

If the vehicle is available to more than one individual, the employer must allocate the gross income attributable to the vehicle (25 percent of the value of the availability of the vehicle) among the employees (and other individuals whose use would not be attributed to an employee) to whom the vehicle was available. This allocation must be done in a reasonable manner to reflect the personal use of the vehicle by the individuals. Amounts that would be allocated to individuals who are not employees (such as a sole proprietor) reduce the amount that may be allocated to employees but are otherwise to be disregarded for purposes of this Q/A-4a.

For purposes of this Q/A-4a(f), the value of the availability of a vehicle may be calculated as if the vehicle had been available to only one employee continuously and without regard to any working condition fringe exclusion.

The following examples illustrate a reasonable allocation of gross income with respect to an employer-provided vehicle between two employees:

Example (1). Assume that two farm employees share the use of a vehicle which for a calendar year is regularly used directly in connection with the business of farming and qualifies for use of the rule in §1.274-6T(b). Employee A uses the vehicle in the morning directly in connection with the business of farming and employee B uses the vehicle in the afternoon directly in connection with the business of farming. Assume further that employee B takes the vehicle home in the evenings and weekends. The employer should allocate all the income attributable to the availability of the vehicle to employee B.

Example (2). Assume that for a calendar year, farm employees C and D share the use of a vehicle that is regularly used directly in connection with the business of farming and qualifies for use of the rule in §1.274-6T(b). Assume further that the employees alternate taking the vehicle home in the evening and alternate the availability to use the vehicle for personal purposes on weekends. The employer should allocate the income attributable to the availability of the vehicle for personal use (25 percent of the value of the availability of the vehicle) equally between the two employees.

Example (3). Assume the same facts as in example (2) except that C is the sole proprietor of the farm. Based on these facts, C should allocate the same amount of income to D as was allocated to D in example (2). No other income attributable to the availability of the vehicle for personal use should be allocated.

Q-4b: What special rule applies with respect to the use of qualified nonpersonal use vehicles?

A-4b: Effective January 1, 1985, one hundred percent of the value of the use of a qualified nonpersonal use vehicle (as described in §1.274-5T(k)) is excluded from gross income as a working condition fringe, provided that, in the case of vehicles described in paragraph (k)(3) through (7) of that section, the use of the vehicles conforms to the requirements of that paragraph.

Par. 5. Section 1.162-25T is revised to read as follows:

§1.162-25T Deductions with respect to noncash fringe benefits (temporary).

(a) *Employer.* If an employer includes the value of a noncash fringe benefit in an employee's gross income, the employer may not deduct this amount as compensation for services, but rather may deduct only the costs incurred by the employer in providing the benefit to the employee. The employer may be allowed a cost recovery deduction under section 168 or a deduction under section 179 for an expense not chargeable to capital account, or, if the noncash fringe benefit is property leased by the employer, a deduction for the ordinary and necessary business expense of leasing the property.

(b) *Employee.* If an employer provides the use of a vehicle (as defined in §1.61-2T Q/A-20) to an employee as a noncash fringe benefit and includes the entire value of the benefit in an employee's gross income without taking into account any exclusion for a working condition fringe allowable under section 132 and the regulations thereunder, the employee may deduct, for purposes of determining adjusted gross income, that value multiplied by the percentage of the total use of the vehicle that is in connection with the employer's trade or business. If the employer determines the value of the noncash fringe benefit under a special accounting rule that allows the employer to treat the value of benefits provided during the last two months of the calendar year or any shorter period as paid during the subsequent calendar year, then the employee must determine the deduction allowable under this paragraph (b) without regard to any use of the benefit during those last two months or any shorter period. The employee may not use a cents-per-mile valuation method to determine the deduction allowable under this paragraph (b).

(c) *Examples.* The following examples illustrate the provisions of this section.

Example (1). On January 1, 1986, X Company owns and provides the use of an automobile with a fair market value of $20,000 to E, an employee, for the entire calendar year. Both X and E compute taxable income on the basis of the calendar year. Seventy percent of the use of the automobile by E is in connection with X's trade or business. If X uses the special rule provided in §1.61-2T for valuing the availability of the automobile and takes into account the amount excludable as a working conditon fringe, X would include $1,680 ($5,600, the Annual Lease Value, less 70 percent of $5,600) in E's gross income for 1986. X may not deduct the amount included in E's income as compensation for services. X may, however, determine a cost recovery deduction under section 168, subject to the limitations under section 280F, for taxable year 1986.

Example (2). The facts are the same as in example (1), except that X includes $5,600 in E's gross income, the value of the noncash fringe benefit without taking into account the amount excludable as a working condition fringe. X may not deduct that amount as compensation for services, but may determine a cost recovery deduction under section 168, subject to the limitations under section 280F. For purposes of determining adjusted gross income, E may deduct $3,920 ($5,600 multiplied by the percent of business use).

Par. 6. New §1.274-5T is added in the appropriate place and reads as follows:

§1.274-5T Substantiation requirements (temporary).

(a) *In general.* For taxable years beginning on or after January 1, 1986, no

deduction or credit shall be allowed with respect to—

(1) Traveling away from home (including meals and lodging),

(2) Any activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such an activity, including the items specified in section 274(e),

(3) Gifts defined in section 274(b), or

(4) Any listed property (as defined in section 280F(d)(4) and §1.280F-6T(b)),

unless the taxpayer substantiates each element of the expenditure or use (as described in paragraph (b) of this section) in the manner provided in paragraph (c) of this section. This limitation supersedes the doctrine founded in *Cohan v. Commissioner*, 39 F.2d 540 (2d Cir. 1930). The decision held that, where the evidence indicated a taxpayer incurred deductible travel or entertainment expenses but the exact amount could not be determined, the court should make a close approximation and not disallow the deduction entirely. Section 274(d) contemplates that no deduction or credit shall be allowed a taxpayer on the basis of such approximations or unsupported testimony of the taxpayer. For purposes of this section, the term "entertainment" means entertainment, amusement, or recreation, and use of a facility therefor; and the term "expenditure" includes expenses and items (including items such as losses and depreciation).

(b) *Elements of an expenditure or use*—(1) *In general.* Section 274(d) and this section contemplate that no deduction or credit shall be allowed for travel, entertainment, a gift, or with respect to listed property unless the taxpayer substantiates the requisite elements of each expenditure or use as set forth in this paragraph (b).

(2) *Travel away from home.* The elements to be proved with respect to an expenditure for travel away from home are—

(i) *Amount.* Amount of each separate expenditure for traveling away from home, such as cost of transportation or lodging, except that the daily cost of the traveler's own breakfast, lunch, and dinner and of expenditures incidental to such travel may be aggregated, if set forth in reasonable categories, such as for meals, for gasoline and oil, and for taxi fares;

(ii) *Time.* Dates of departure and return for each trip away from home, and number of days away from home spent on business;

(iii) *Place.* Destinations or locality of travel, described by name of city or town or other similar designation; and

(iv) *Business purpose.* Business reason for travel or nature of the business benefit derived or expected to be derived as a result of travel.

(3) *Entertainment in general.* The elements to be proved with respect to an expenditure for entertainment are—

(i) *Amount.* Amount of each separate expenditure for entertainment, except that such incidental items as taxi fares or telephone calls may be aggregated on a daily basis;

(ii) *Time.* Date of entertainment;

(iii) *Place.* Name, if any address or location, and designation of type of entertainment, such as dinner or theater, if such information is not apparent from the designation of the place;

(iv) *Business purpose.* Business reason for the entertainment or nature of business benefit derived or expected to be derived as a result of the entertainment and, except in the case of business meals described in section 274(e)(1), the nature of any business discussion or activity;

(v) *Business relationship.* Occupation or other information relating to the person or persons entertained, including name, title, or other designation, sufficient to establish business relationship to the taxpayer.

(4) *Entertainment directly preceding or following a substantial and bona fide business discussion.* If a taxpayer claims a deduction for entertainment directly preceding or following a substantial and bona fide business discussion on the ground that such entertainment was associated with the active conduct of the taxpayer's trade or business, the elements to be proved with respect to such expenditure, in addition to those enumerated in paragraph (b)(3)(i), (ii), (iii), and (v) of this section are—

(i) *Time.* Date and duration of business discussion;

(ii) *Place.* Place of business discussion;

(iii) *Business purpose.* Nature of business discussion, and business reason for the entertainment or nature of business benefit derived or expected to be derived as the result of the entertainment;

(iv) *Business relationship.* Identification of those persons entertained who participated in the business discussion.

(5) *Gifts.* The elements to be proved with respect to an expenditure for a gift are—

(i) *Amount.* Cost of the gift to the taxpayer;

(ii) *Time.* Date of the gift;

(iii) *Description.* Description of the gift;

(iv) *Business purpose.* Business reason for the gift or nature of business benefit derived or expected to be derived as a result of the gift; and

(v) *Business relationship.* Occupation or other information relating to the recipient of the gift, including name, title, or other designation, sufficient to establish business relationship to the taxpayer.

(6) *Listed property.* The elements to be proved with respect to any listed property are—

(i) *Amount*—(A) *Expenditures.* The amount of each separate expenditure with respect to an item of listed property, such as the cost of acquisition, the cost of capital improvements, lease payments, the cost of maintenance and repairs, or other expenditures, and

(B) *Uses.* The amount of each business/investment use (as defined in §1.280F-6T(d)(3) and (e)), based on the appropriate measure (i.e., mileage for automobiles and other means of transportation and time for other listed property, unless the Commissioner approves an alternative method), and the total use of the listed property for the taxable period.

(ii) *Time.* Date of the expenditure or use with respect to listed property, and

(iii) *Business or investment purpose.* The business purpose for an expenditure or use with respect to any listed property (*see* §1.274-5T(c)(6)(i)(B) and (C) for special rules for the aggregation of expenditures and business use and §1.280F-6T(d)(2) for the distinction between qualified business use and business/investment use).

See also §1.274-5T(e) relating to the substantiation of business use of employer-provided listed property and

§1.274-6T for special rules for substantiating the business/investment use of certain types of listed property.

(c) *Rules of substantiation*—(1) *In general.* Except as otherwise provided in this section and §1.274-6T, a taxpayer must substantiate each element of an expenditure or use (described in paragraph (b) of this section) by adequate records or by sufficient evidence corroborating his own statement. Section 274(d) contemplates that a taxpayer will maintain and produce such substantiation as will constitute proof of each expenditure or use referred to in section 274. Written evidence has considerably more probative value than oral evidence alone. In addition, the probative value of written evidence is greater the closer in time it relates to the expenditure or use. A contemporaneous log is not required, but a record of the elements of an expenditure or of a business use of listed property made at or near the time of the expenditure or use, supported by sufficient documentary evidence, has a high degree of credibility not present with respect to a statement prepared subsequent thereto when generally there is a lack of accurate recall. Thus, the corroborative evidence required to support a statement not made at or near the time of the expenditure or use must have a high degree of probative value to elevate such statement and evidence to the level of credibility reflected by a record made at or near the time of the expenditure or use supported by sufficient documentary evidence. The substantiation requirements of section 274(d) are designed to encourage taxpayers to maintain the records, together with documentary evidence, as provided in paragraph (c)(2) of this section.

(2) *Substantiation by adequate records*—(i) *In general.* To meet the "adequate records" requirements of section 274(d), a taxpayer shall maintain an account book, diary, log, statement of expense, trip sheets, or similar record (as provided in paragraph (c)(2)(ii) of this section), and documentary evidence (as provided in paragraph (c)(2)(iii) of this section) which, in combination, are sufficient to establish each element of an expenditure or use specified in paragraph (b) of this section. It is not necessary to record information in an account book, diary, log, statement of expense, trip sheet, or similar record which duplicates information reflected on a receipt so long as the account book, etc. and receipt complement each other in an orderly manner.

(ii) *Account book, diary, etc.* An account book, diary, log, statement of expense, trip sheet, or similar record must be prepared or maintained in such manner that each recording of an element of an expenditure or use is made at or near the time of the expenditure or use.

(A) *Made at or near the time of the expenditure or use.* For purposes of this section, the phrase "made at or near the time of the expenditure or use" means the elements of an expenditure or use are recorded at a time when, in relation to the use or making of an expenditure, the taxpayer has full present knowledge of each element of the expenditure or use, such as the amount, time, place, and business purpose of the expenditure and business relationship. An expense account statement which is a transcription of an account book, diary, log, or similar record prepared or maintained in accordance with the provisions of this paragraph (c)(2)(ii) shall be considered a record prepared or maintained in the manner prescribed in the preceding sentence if such expense account statement is submitted by an employee to his employer or by an independent contractor to his client or customer in the regular course of good business practice. For example, a log maintained on a weekly basis, which accounts for use during the week, shall be considered a record made at or near the time of such use.

(B) *Substantiation of business purpose.* In order to constitute an adequate record of business purpose within the meaning of section 274(d) and this paragraph (c)(2), a written statement of business purpose generally is required. However, the degree of substantiation necessary to establish business purpose will vary depending upon the facts and circumstances of each case. Where the business purpose is evident from the surrounding facts and circumstances, a written explanation of such business purpose will not be required. For example, in the case of a salesman calling on customers on an established sales route, a written explanation of the business purpose of such travel ordinarily will not be required. Similarly, in the case of a business meal described in section 274(e)(1), if the business purpose of such meal is evident from the business relationship to the taxpayer of the persons entertained and other surrounding circumstances, a written explanation fo such business purpose will not be required.

(C) *Substantiation of business use of listed property*—(1) *Degree of substantiation.* In order to constitute an adequate record (within the meaning of section 274(d) and this paragraph (c)(2)(ii)), which substantiates business/investment use of listed property (as defined in §1.280F-6T(d)(3)), the record must contain sufficient information as to each element of every business/investment use. However, the level of detail required in an adequate record to substantiate business investment use may vary depending upon the facts and circumstances. For example, a taxpayer who uses a truck for both business and personal purposes and whose only business use of a truck is to make deliveries to customers on an established route may satisfy the adequate record requirement by recording the total number miles driven during the taxable year, the length of the delivery route once, and the date of each trip at or near the time of the trips. Alternatively, the taxpayer may establish the date of each trip with a receipt, record of delivery, or other documentary evidence.

(2) Written record. Generally, an adequate record must be written. However, a record of the business use of listed property, such as a computer or automobile, prepared in a computer memory device with the aid of a logging program will constitute an adequate record.

(D) *Confidential information.* If any information relating to the elements of an expenditure or use, such as place, business purpose, or business relationship, is of a confidential nature, such information need not be set forth in the account book, diary, log, statement of expense, trip sheet, or similar record, provided such information is recorded at or near the time of the expenditure or use and is elsewhere available to the district director to substantiate such element of the expenditure or use.

(iii) *Documentary evidence.* Documentary evidence, such as receipts, paid bills, or similar evidence sufficient to support an expenditure shall be required for—

(A) Any expenditure for lodging while traveling away from home, and

(B) Any other expenditure of $25 or more, except, for transportation charges, documentary evidence will not be required if not readily available,

provided, however, that the Commissioner, in his discretion, may prescribe rules waiving such requirements in circumstances where he determines it is impracticable for such documentary evidence to be required. Ordinarily, documentary evidence will be considered adequate to support an expenditure if it includes sufficient information to establish the amount, date, place, and the essential character of the expenditure. For example, a hotel receipt is sufficient to support expenditures for business travel if it contains the following: name, location, date, and separate amounts for charges such as for lodging, meals, and telephone. Similarly, a restaurant receipt is sufficient to support an expenditure for a business meal if it contains the following: name and location of the restaurant, the date and amount of the expenditure, the number of people served, and, if a charge is made for an item other than meals and beverages, an indication that such is the case. A document may be indicative of only one (or part of one) element of an expenditure. Thus, a cancelled check together with a bill from the payee, ordinarily would establish the element of cost. In contrast, a cancelled check drawn payable to a named payee would not by itself support a business expenditure without other evidence showing that the check was used for a certain business purpose.

(iv) *Retention of written evidence.* The Commissioner may, in his discretion, prescribe rules under which an employer may dispose of the adequate records and documentary evidence submitted to him by employees who are required to, and do, make an adequate accounting to the employer (within the meaning of paragraph (f)(4) of this section) if the employer maintains adequate accounting procedures with respect to such employees (within the meaning of paragraph (f)(5) of this section).

(v) *Substantial compliance.* If a taxpayer has not fully substantiated a particular element of an expenditure or use, but the taxpayer establishes to the satisfaction of the district director that he has substantially complied with the "adequate records" requirements of this paragraph (c)(2) with respect to the expenditure or use, the taxpayer may be permitted to establish such element by evidence which the district director shall deem adequate.

(3) *Substantiation by other sufficient evidence*—(i) *In general.* If a taxpayer fails to establish to the satisfaction of the district director that he has substantially complied with the "adequate records" requirements of paragraph (c)(2) of this section with respect to an element of an expenditure or use, then, except as otherwise provided in this paragraph, the taxpayer must establish such element—

(A) By his own statement, whether written or oral, containing specific information in detail as to such element; and

(B) By other corroborative evidence sufficient to establish such element.

If such element is the description of a gift, or the cost or amount, time, place, or date of an expenditure or use, the corroborative evidence shall be direct evidence, such as a statement in writing or the oral testimony of persons entertained or other witnesses setting forth detailed information about such element, or the documentary evidence described in paragraph (c)(2) of this section. If such element is either the business relationship to the taxpayer of persons entertained, or the business purpose of an expenditure, the corroborative evidence may be circumstantial evidence.

(ii) *Sampling*—(A) *In general.* Except as provided in paragraph (c)(3)(ii)(B) of this section, a taxpayer may maintain an adequate record for portions of a taxable year and use that record to substantiate the business/investment use of listed property for all or a portion of the taxable year if the taxpayer can demonstrate by other evidence that the periods for which an adequate record is maintained are representative of the use for the taxable year or a portion thereof.

(B) *Exception for pooled vehicles.* The sampling method of paragraph (c)(3)(ii)(A) of this section may not be used to substantiate the business/investment use of an automobile or other vehicle of an employer that is made available for use by more than one employee for all or a portion of a taxable year.

(C) *Examples.* The following examples illustrate this paragraph (c)(3)(ii).

Example (1). A, a sole proprietor and calendar year taxpayer, operates an interior decorating business out of her home. A uses an automobile for local business travel to visit the homes or offices of clients, to meet with suppliers and other subcontractors, and to pick up and deliver certain items to clients when feasible. There is no other business use of the automobile but A and other members of her family also use the automobile for personal purposes. A maintains adequate records for the first three months of 1986 that indicate that 75 percent of the use of the automobile was in A's business. Invoices from subcontractors and paid bills indicate the A's business continued at approximately the same rate for the remainder of 1986. If other circumstances do not change (e.g., A does not obtain a second car for exclusive use in her business), the determination that the business/investment use of the automobile for the taxable year is 75 percent is based on sufficient corroborative evidence.

Example (2). The facts are the same as in example (1), except that A maintains adequate records during the first week of every month, which indicate that 75 percent of the use of the automobile is in A's business. The invoices from A's business indicate that A's business continued at the same rate during the subsequent weeks of each month so that A's weekly records are representative of each month's business use of the automobile. Thus, the determination that the business/investment use of the automobile for the taxable year is 75 percent is based on sufficient corroborative evidence.

Example (3). B, a sole proprietor and calendar year taxpayer, is a salesman in a large metropolitan area for a company that manufactures household products. For the first three weeks of each month, B uses his own automobile occasionally to travel within the metropolitan area on business. During these three weeks, B's use of the automobile for business purposes does not follow a consistent pattern from day to day or week to week. During the fourth week of each month, B delivers to his customers all the orders taken during the previous month. B's use of his automobile for business purposes, as substantiated by adequate records, is 70 percent of the total use during that fourth week. In this example, a determination based on the records maintained during that fourth week that the business/investment use of the automobile for the taxable year is 70 percent is not based on sufficient corroborative evidence because use during this week is not representative of use during other periods.

(iii) *Special rules.* See §1.274-6T for special rules for substantiation by sufficient corroborating evidence with respect to certain listed property.

(4) *Substantiation in exceptional circumstances.* If a taxpayer establishes that, by reason of the inherent nature of the situation—

(i) He was unable to obtain evidence with respect to an element of the expenditure or use which conforms fully to the "adequate records" requirements of paragraph (c)(2) of this section,

(ii) He is unable to obtain evidence with respect to such element which conforms fully to the "other sufficient evidence" requirements of paragraph (c)(3) of this section, and

(iii) He has presented other evidence, with respect to such element, which possesses the highest degree of probative value possible under the circumstances, such other evidence shall be considered to satisfy the substantiation requirements of section 274(d) and this paragraph.

(5) *Loss of records due to circumstances beyond control of the taxpayer.* Where the taxpayer establishes that the failure to produce adequate records is due to the loss of such records through circumstances beyond the taxpayer's control, such as destruction by fire, flood, earthquake, or other casualty, the taxpayer shall have a right to substantiate a deduction by reasonable reconstruction of his expenditures or use.

(6) *Special rules*—(i) *Separate expenditure or use*—(A) *In general.* For the purposes of this section, each separate payment or use by the taxpayer shall ordinarily be considered to constitute a separate expenditure. However, concurrent or repetitious expenses or uses may be substantiated as a single item. To illustrate the above rules, where a taxpayer entertains a business guest at dinner and thereafter at the theater, the payment for dinner shall be considered to constitute one expenditure and the payment for the tickets for the theater shall be considered to constitute a separate expenditure. Similarly, if during a day of business travel a taxpayer makes separate payments for breakfast, lunch, and dinner, he shall be considered to have made three separate expenditures. However, if during entertainment at a cocktail lounge the taxpayer pays separately for each serving of refreshments, the total amount expended for the refreshments will be treated as a single expenditure. A tip may be treated as a separate expenditure.

(B) *Aggregation of expenditures.* Except as otherwise provided in this section, the account book, diary, log, statement of expense, trip sheet, or similar record required by paragraph (c)(2)(ii) of this section shall be maintained with respect to each separate expenditure and not with respect to aggregate amounts for two or more expenditures. Thus, each expenditure for such items as lodging and air or rail travel shall be recorded as a separate item and not aggregated. However, at the option of the taxpayer, amounts expended for breakfast, lunch, or dinner, may be aggregated. A tip or gratuity which is related to an underlying expense may be aggregated with such expense. In addition, amounts expended in connection with the use of listed property during a taxable year, such as for gasoline or repairs for an automobile, may be aggregated. If these expenses are aggregated, the taxpayer must establish the date and amount, but need not prove the business purpose of each expenditure. Instead, the taxpayer may prorate the expenses based on the total business use of the listed property. For other provisions permitting recording of aggregate amounts in an account book, diary, log, statement of expense, trip sheet, or similar record, see paragraphs (b)(2)(i) and (b)(3) of this section (relating to incidental costs of travel and entertainment).

(C) *Aggregation of business use.* Uses which may be considered part of a single use, for example, a round trip or uninterrupted business use, may be accounted for by a single record. For example, use of a truck to make deliveries at several different locations which begins and ends at the business premises and which may include a stop at the business premises in between two deliveries may be accounted for by a single record of miles driven. In addition, use of a passenger automobile by a salesman for a business trip away from home over a period of time may be accounted for by a single record of miles traveled. De minimis personal use (such as a stop for lunch on the way between two business stops) is not an interruption of business use.

(ii) *Allocation of expenditure.* For purposes of this section, if a taxpayer has established the amount of an expenditure, but is unable to establish portion of such amount which is att utable to each person participatin the event giving rise to the expendit such amount shall ordinarily be a cated to each participant on a pro basis, if such determination is mate Accordingly, the total number of sons for whom a travel or entert ment expenditure is incurred mus established in order to compute portion of the expenditure allocabl each such person.

(iii) *Primary use of a facility.* S tion 274(a)(1)(B) and (2)(C) deny a duction for any expenditure paid incurred before January 1, 1979, respect to a facility, or paid or incu at any time with respect to a club, u in connection with an entertainment tivity unless the taxpayer establis that the facility (including a club) used primarily for the furtherance the taxpayer's trade or business. A termination whether a facility bef January 1, 1979, or a club at any ti was used primarily for the furthera of the taxpayer's trade or business depend upon the facts and circu stances of each case. In order to es lish that a facility was used prima for the furtherance of his trade or b ness, the taxpayer shall maintain ords of the use of the facility, the of using the facility, mileage or equivalent (if appropriate), and s other information as shall tend to es lish such primary use. Such record use shall contain—

(A) For each use of the faci claimed to be in furtherance of the payer's trade or business, the eleme of an expenditure specified in pa graph (b)(3) of this section, and

(B) For each use of the facility no furtherance of the taxpayer's trad business, an appropriate description such use, including cost, date, num of persons entertained, nature of en tainment and, if applicable, informat such as mileage or its equivalent. A tation such as "personal use" or "fam use" would, in the case of such use, sufficient to describe the nature entertainment.

If a taxpayer fails to maintain adeq records concerning a facility whic likely to serve the personal purpose the taxpayer, it shall be presumed the use of such facility was prima

personal.

(iv) *Additional information.* In a case where it is necessary to obtain additional information, either—

(A) To clarify information contained in records, statements, testimony, or documentary evidence submitted by a taxpayer under the provisions of paragraph (c)(2) or (c)(3) of this section, or

(B) To establish the reliability or accuracy of such records, statements, testimony, or documentary evidence,

the district director may, notwithstanding any other provision of this section, obtain such additional information by personal interview or otherwise as he determines necessary to implement properly the provisions of section 274 and the regulations thereunder.

(7) *Specific exceptions.* Except as otherwise prescribed by the Commissioner, substantiation otherwise required by this paragraph is not required for—

(i) Expenses described in section 274(e)(2) relating to food and beverages for employees, section 274(e)(3) relating to expenses treated as compensation, section 274(e)(8) relating to items available to the public, and section 274(e)(9) relating to entertainment sold to customers, and

(ii) Expenses described in section 274(e)(5) relating to recreational, etc., expenses for employees, except that a taxpayer shall keep such records or other evidence as shall establish that such expenses were for activities (or facilities used in connection therewith) primarily for the benefit of employees other than employees who are officers, shareholders or other owners (as defined in section 274(e)(5)), or highly compensated employees.

(d) *Disclosure on returns*—(1) *In general.* The Commissioner may, in his discretion, prescribe rules under which any taxpayer claiming a deduction or credit for entertainment, gifts, travel, or with respect to listed property, or any other person receiving advances, reimbursements, or allowances for such items, shall make disclosure on his tax return with respect to such items. The provisions of this paragraph shall apply notwithstanding the provisions of paragraph (f) of this section.

(2) *Business use of passenger automobiles and other vehicles.* (i) On returns for taxable years beginning after December 31, 1984, taxpayers that claim a deduction or credit with respect to any vehicle are required to answer certain questions providing information about the use of the vehicle. The information required on the tax return relates to mileage (total, business, commuting, and other personal mileage), percentage of business use, date placed in service, use of other vehicles, after-work use, whether the taxpayer has evidence to support the business use claimed on the return, and whether or not the evidence is written.

(ii) Any employer that provides the use of a vehicle to an employee must obtain information from the employee sufficient to complete the employer's tax return. Any employer that provides more than five vehicles to its employees need not include any information on its return. The employer, instead, must obtain the information from its employees, indicate on its return that it has obtained the information, and retain the information received. Any employer—

(A) That can satisfy the requirements of §1.274-6T(a)(2), relating to vehicles not used for personal purposes,

(B) That can satisfy the requirements of §1.274-6T(a)(3), relating to vehicles not used for personal purposes other than commuting, or

(C) That treats all use of vehicles by employees as personal use

need not obtain information with respect to those vehicles, but instead must indicate on its return that it has vehicles exempt from the requirements of this paragraph (d)(2).

(3) *Business use of other listed property.* On returns for taxable years beginning after December 31, 1984, taxpayers that claim a deduction or credit with respect to any listed property other than a vehicle (for example, a yacht, airplane, or certain computers) are required to provide the following information:

(i) The date that the property was placed in service,

(ii) The percentage of business use,

(iii) Whether evidence is available to support the percentage of business use claimed on the return, and

(iv) Whether the evidence is written.

(e) *Substantiation of the business use of listed property made available by an employer for use by an employer*—(1) *Employee*—(i) *In general.* An employee may not exclude from gross income as a working condition fringe any amount of the value of the availability of listed property provided by an employer to the employee, unless the employee substantiates for the period of availability the amount of the exclusion in accordance with the requirements of section 274(d) and either this section or §1.274-6T.

(ii) *Vehicles treated as used entirely for personal purposes.* If an employer includes the value of the availability of a vehicle (as defined in §1.61-2T Q/A-20) in an employee's gross income without taking into account any exclusion for a working condition fringe allowable under section 132 and the regulations thereunder with respect to the vehicle, the employee must substantiate any deduction claimed under §1.162-25T for the business/investment use of the vehicle in accordance with the requirements of section 274(d) and either this section or §1.274-6T.

(2) *Employer*—(i) *In general.* An employer substantiates its business/investment use of listed property by showing either—

(A) That, based on evidence that satisfies the requirements of section 274(d) or statements submitted by employees that summarize such evidence, all or a portion of the use of the listed property is by employees in the employer's trade or business and, if any employee used the property for personal purposes, the employer included an appropriate amount in the employee's income, or

(B) In the case of a vehicle, the employer treats all use by employees as personal use and includes an appropriate amount in the employees' income.

(ii) *Reliance on employee records.* For purposes of substantiating the business/investment use of listed property that an employer provides to an employee and for purposes of the information required by paragraph (d)(2) and (3) of this section, the employer may rely on adequate records maintained by the employee or on the employee's own statement if corroborated by other sufficient evidence unless the employer knows or has reason to know that the statement, records, or other evidence are not accurate. The employer must retain a copy of the adequate rec-

ords maintained by the employee or the other sufficient evidence, if available. Alternatively, the employer may rely on a statement submitted by the employee that provides sufficient information to allow the employer to determine the business/investment use of the property unless the employer knows or has reason to know that the statement is not based on adequate records or on the employee's own statement corroborated by other sufficient evidence. If the employer relies on the employee's statement, the employer must retain only a copy of the statement. The employee must retain a copy of the adequate records or other evidence.

(f) *Reporting and substantiation of expenses of certain employees for travel, entertainment, gifts, and with respect to listed property*—(1) *In general.* The purpose of this paragraph is to provide rules for reporting and substantiation of certain expenses paid or incurred by employees in connection with the performance of services as employees. For purposes of this paragraph, the term "business expenses" means ordinary and necessary expenses for travel, entertainment, gifts, or with respect to listed property which are deductible under section 162, and the regulations thereunder, to the extent not disallowed by sections 262, 274(c), and 280F. Thus, the term "business expenses" does not include personal, living, or family expenses disallowed by section 262, travel expenses disallowed by section 274(c), or cost recovery deductions and credits with respect to listed property disallowed by section 280F(d)(3) because the use of such property is not for the convenience of the employer and required as a condition of employment. Except as provided in paragraph (f)(2), advances, reimbursements, or allowances for such expenditures must be reported as income by the employee.

(2) *Reporting of expenses for which the employee is required to make an adequate accounting to his employer*—(i) *Reimbursements equal to expenses.* For purposes of computing tax liability, an employee need not report on his tax return business expenses for travel, transportation, entertainment, gifts, or with respect to listed property, paid or incurred by him solely for the benefit of his employer for which he is required to, and does, make an adequate accounting to his employer (as defined in paragraph (f)(4) of this section) and which are charged directly or indirectly to the employer (for example, through credit cards) or for which the employee is paid through advances, reimbursements, or otherwise, provided that the total amount of such advances, reimbursements, and charges is equal to such expenses.

(ii) *Reimbursements in excess of expenses.* In case the total of the amounts charged directly or indirectly to the employer or received from the employer as advances, reimbursements, or otherwise, exceeds the business expenses paid or incurred by the employee and the employee is required to, and does, make an adequate accounting to his employer for such expenses, the employee must include such excess (including amounts received for expenditures not deductible by him) in income.

(iii) *Expenses in excess of reimbursements.* If an employee incurs deductible business expenses on behalf of his employer which exceed the total of the amounts charged directly or indirectly to the employer and received from the employer as advances, reimbursements, or otherwise, and the employee makes an adequate accounting to his employer, the employee must be able to substantiate any deduction for such excess with such records and supporting evidence as will substantiate each element of an expenditure (described in paragraph (b) of this section) in accordance with paragraph (c) of this section.

(3) *Reporting of expenses for which the employee is not required to make an adequate accounting to his employer.* If the employee is not required to make an adequate accounting to his employer for his business expenses, or, though required, fails to make an adequate accounting for such expenses, he must submit, as a part of his tax return, the appropriate form issued by the Internal Revenue Service for claiming deductions for employee business expenses (e.g., Form 2106, Employee Business Expenses, for 1985) and provide the information requested on that form, including the information required by paragraph (d)(2) and (3) of this section if the employee's business expenses are with respect to the use of listed property. In addition, the ployee must maintain such records supporting evidence as will substan each element of an expenditure or (described in paragraph (b) of this tion) in accordance with paragraph of this section.

(4) *Definition of an "adequate counting" to the employer.* For poses of this paragraph an adequate counting means the submission to employer of an account book, di log, statement of expenses, trip sh or similar record maintained by the ployee in which the information a each element of an expenditure or (described in paragraph (b) of this tion) is recorded at or near the tim the expenditure or use, together supporting documentary evidence, manner which conforms to all the " quate records" requirements of p graph (c)(2) of this section. An quate accounting requires that employee account for all amounts ceived from his employer during taxable year as advances, reimbu ments, or allowances (including t charged directly or indirectly to the ployer through credit cards or ot wise) for travel, entertainment, g and the use of listed property. methods of substantiation allowed der paragraph (c)(4) or (c)(5) of section also will be considered to b adequate accounting if the employe cepts an employee's substantiation establishes that such substantia meets the requirements of such p graph (c)(4) or (c)(5). For purpose an adequate accounting, the metho substantiation allowed under parag (c)(3) of this section will not permitted.

(5) *Substantiation of expenditure certain employees.* An employee makes an adequate accounting to employer within the meaning of paragraph will not again be require substantiate such expense accoun formation except in the follow cases:

(i) An employee whose business penses exceed the total of amo charged to his employer and amo received through advances, reimbu ments or otherwise and who clai deduction on his return for such exc

(ii) An employee who is relate his employer within the meanin

section 267(b), but for this purpose the percentage referred to in section 267(b)(2) shall be 10 percent, and

(iii) Employees in cases where it is determined that the accounting procedures used by the employer for the reporting and substantiation of expenses by such employees are not adequate, or where it cannot be determined that such procedures are adequate. The district director will determine whether the employer's accounting procedures are adequate by considering the facts and circumstances of each case, including the use of proper internal controls. For example, an employer should require that an expense account be verified and approved by a reasonable person other than the person incurring such expenses. Accounting procedures will be considered inadequate to the extent that the employer does not require an adequate accounting from his employees as defined in paragraph (f)(4) of this section, or does not maintain such substantiation. To the extent an employer fails to maintain adequate accounting procedures he will thereby obligate his employees to substantiate separately their expense account information.

(g) *Substantiation by reimbursement arrangements or per diem, mileage, and other traveling allowances.* The Commissioner may, in his discretion, prescribe rules under which—

(1) Reimbursement arrangements covering ordinary and necessary expenses of traveling away from home (exclusive of transportation expenses to and from destination),

(2) Per diem allowances providing for ordinary and necessary expenses of traveling away from home (exclusive of transportation costs to and from destination), and

(3) Mileage allowances providing for ordinary and necessary expenses of local travel and transportation while traveling away from home,

will, if in accordance with reasonable business practice, be regarded as equivalent to substantiation by adequate records or other sufficient evidence for purposes of paragraph (c) of this section of the amount of such expenses and as satisfying, with respect to the amount of such expenses, the requirements of an adequate accounting to the employer for purposes of paragraph (f)(4) of this section. If the total allowance received exceeds the deductible expenses paid or incurred by the employee, such excess must be reported as income on the employee's return. A mileage allowance provided under paragraph (g)(3) of this section is available only to the owner of a vehicle. *See* paragraph (j) of this section relating to the substantiation of meal expenses while traveling away from home.

(h) *Reporting and substantiation of certain reimbursements of person other than employees*—(1) *In general.* The purpose of this paragraph is to provide rules for the reporting and substantiation of certain expenses for travel, entertainment, gifts, or with respect to listed property paid or incurred by one person (hereinafter termed "independent contractor") in connection with services performed for another person other than an employer (hereinafter termed "client or customer") under a reimbursement or other expense allowance arrangement with such client or customer. For purposes of this paragraph, the term, "business expenses" means ordinary and necessary expenses for travel, entertainment, gifts, or with respect to listed property which are deductible under section 162, and the regulations thereunder, to the extent not disallowed by sections 262 and 274(c). Thus, the term "business expenses" does not include personal, living, or family expenses disallowed by section 262 or travel expenses disallowed by section 274(c), and reimbursements for such expenditures must be reported as income by the independent contractor. For purposes of this paragraph, the term "reimbursements" means advances, allowances, or reimbursements received by an independent contractor for travel, entertainment, gifts, or with respect to listed property in connection with the performance by him of services for his client or customer, under a reimbursement or other expense allowance arrangement with his client or customer, and includes amounts charged directly or indirectly to the client or customer through credit card systems or otherwise. *See* paragraph (j) of this section relating to the substantiation of meal expenses while traveling away from home.

(2) *Substantiation by independent contractors.* An independent contractor shall substantiate, with respect to his reimbursements, each element of an expenditure (described in paragraph (b) of this section) in accordance with the requirements of paragraph (c) of this section; and, to the extent he does not so substantiate, he shall include such reimbursements in income. An independent contractor shall so substantiate a reimbursement for entertainment regardless of whether he accounts (within the meaning of paragraph (h)(3) of this section) for such entertainment.

(3) *Accounting to a client or customer under section 274(e)(4)(B).* Section 274(e)(4)(B) provides that section 274(a) (relating to disallowance of expenses for entertainment) shall not apply to expenditures for entertainment for which an independent contractor has been reimbursed if the independent contractor accounts to his client or customer, to the extent provided by section 274(d). For purposes of section 274(e)(4)(B), an independent contractor shall be considered to account to his client or customer for all expense paid or incurred under a reimbursement or other expense allowance arrangement with his client or customer if, with respect to such expense for entertainment, he submits to his client or customer adequate records or other sufficient evidence conforming to the requirements of paragraph (c) of this section.

(4) *Substantiation by client or customer.* A client or customer shall not be required to substantiate, in accordance with the requirements of paragraph (c) of this section, reimbursements to an independent contractor for travel and gifts, or for entertainment unless the independent contractor has accounted to him (within the meaning of section 274(e)(4)(B) and paragraph (h)(3) of this section) for such entertainment. If an independent contractor has so accounted to a client or customer for entertainment, the client or customer shall substantiate each element of the expenditure (as described in paragraph (b) of this section) in accordance with the requirements of paragraph (c) of this section.

(i) [Reserved].

(j) *Authority for an optional method of computing meal expenses while traveling away from home.* The Commissioner may establish a method under which a taxpayer may elect to use a

specified amount or amounts for meals while traveling away from home in lieu of substantiating the actual cost of meals. The taxpayer would not be relieved of substantiating the actual cost of other travel expenses as well as the time, place, and business purpose of the travel. See paragraphs (b)(2) and (c) of this section.

(k) *Exceptions for qualified nonpersonal use vehicles*—(1) *In general.* The substantiation requirements of section 274(d) and this section do not apply to any qualified nonpersonal use vehicle (as defined in paragraph (k)(2) of this section).

(2) *Qualified nonpersonal use vehicle*—(i) *In general.* For purposes of section 274(d) and this section, the term "qualified nonpersonal use vehicle" means any vehicle which, by reason of its nature (i.e., design), is not likely to be used more than a de minimis amount for personal purposes.

(ii) *List of vehicles.* Vehicles which are qualified nonpersonal use vehicles include the following—

(A) Clearly marked police and fire vehicles (as defined and to the extent provided in paragraph (k)(3) of this section),

(B) Ambulances used as such or hearses used as such,

(C) Any vehicle designed to carry cargo with a loaded gross vehicle weight over 14,000 pounds,

(D) Bucket trucks ("cherry pickers"),

(E) Cement mixers,.

(F) Combines,

(G) Cranes and derricks,

(H) Delivery trucks with seating only for the driver, or only for the driver plus a folding jump seat,

(I) Dump trucks (including garbage trucks),

(J) Flatbed trucks,

(K) Forklifts,

(L) Passenger buses used as such with a capacity of at least 20 passengers,

(M) Qualified moving vans (as defined in paragraph (k)(4) of this section),

(N) Qualified specialized utility repair trucks (as defined in paragraph (k)(5) of this section),

(O) Refrigerated trucks,

(P) School buses (as defined in section 4221(d)(7)(C)),

(Q) Tractors and other special purpose farm vehicles,

(R) Unmarked vehicles used by law enforcement officers (as defined in paragraph (k)(6) of this section) if the use is officially authorized, and

(S) Such other vehicles as the Commissioner may designate.

(3) *Clearly marked police or fire vehicles.* A police or fire vehicle is a vehicle, owned or leased by a governmental unit, or any agency or instrumentality thereof, that is required to be used for commuting by a police officer or fire fighter who, when not on a regular shift, is on call at all times, provided that any personal use (other than commuting) of the vehicle outside the limit of the police officer's arrest powers or the fire fighter's obligation to respond to an emergency is prohibited by such governmental unit. A police or fire vehicle is clearly marked if, through painted insignia or words, it is readily apparent that the vehicle is a police or fire vehicle. A marking on a license plate is not a clear marking for purpose of this paragraph (k).

(4) *Qualified moving van.* The term "qualified moving van" means any truck or van used by a professional moving company in the trade or business of moving household or business goods if—

(i) No personal use of the van is allowed other than for travel to and from a move site (or for de minimis personal use, such as a stop for lunch on the way between two move sites),

(ii) Personal use for travel to and from a move site is an irregular practice (i.e., not more than five times a month on average), and

(iii) Personal use is limited to situations in which it is more convenient to the employer, because of the location of the employee's residence in relation to the location of the move site, for the van not to be returned to the employer's business location.

(5) *Qualified specialized utility repair truck.* The term "qualified specialized utility repair truck" means any truck (not including a van or pickup truck) specifically designed and used to carry heavy tools, testing equipment, or parts if—

(i) The shelves, racks, or other permanent interior construction which has been installed to carry and store such heavy items is such that it is unlikely that the truck will be used more than de minimis amount for personal pu poses, and

(ii) The employer requires the em ployee to drive the truck home in ord to be able to respond in emergency si uations for purposes of restoring maintaining electricity, gas, telephon water, sewer, or steam utility service

(6) *Unmarked law enforcemen vehicles*—(i) *In general.* The substant ation requirements of section 274(d and this section do not apply to offi cially authorized uses of an unmarke vehicle by a "law enforcement officer' To qualify for this exception, any pe sonal use must be authorized by th Federal, State, county, or local gover mental agency or department that own or leases the vehicle and employs th officer, and must be incident to law enforcement functions, such as bein able to report directly from home to stakeout or surveillance site, or to a emergency situation. Use of a unmarked vehicle for vacation or recr ation trips cannot qualify as an autho ized use.

(ii) *Law enforcement officer.* Th term "law enforcement officer" mean an individual who is employed on full-time basis by a governmental un that is responsible for the prevention investigation of crime involving injur to persons or property (including appr hension or detention of persons fo such crimes), who is authorized by la to carry firearms, execute search wa rants, and to make arrests (other tha merely a citizen's arrest), and who re ularly carries firearms (except when is not possible to do so because of th requirements of undercover work). Th term "law enforcement officer" may in clude an arson investigator if the inve tigator otherwise meets the requir ments of this paragraph (i)(6)(ii), b does not include Internal Revenu Service special agents.

(7) *Trucks and vans.* The substanti tion requirements of section 274(d) an this section apply generally to an pickup truck or van, unless the truck van has been specially modified wi the result that it is not likely to be use more than a de minimis amount fo personal purposes. For example, a va that has only a front bench for seatin in which permanent shelving that fil most of the cargo area has been i

stalled, that constantly carries merchandise or equipment, and that has been specially painted with advertising or the company's name, is a vehicle not likely to be used more than a de minimis amount for personal purposes.

(8) *Examples.* The following examples illustrate the provisions of paragraph (k)(3) and (6) of this section:

Example (1). Detective C, who is a "law enforcement officer" employed by a state police department, headquartered in city M, is provided with an unmarked vehicle (equipped with radio communication) for use during off-duty hours because C must be able to communicate with headquarters and be available for duty at any time (for example, to report to a surveillance or crime site). The police department generally has officially authorized personal use of the vehicle by C but has prohibited use of the vehicle for recreational purposes or for personal purposes outside the state. Thus, C's use of the vehicle for commuting between headquarters or a surveillance site and home and for personal errands is authorized personal use as described in paragraph (k)(6)(i) of this section. With respect to these authorized uses, the vehicle is not subject to the substantiation requirements of section 274(d) and the value of these uses is not included in C's gross income.

Example (2). Detective T is a "law enforcement officer" employed by city M. T is authorized to make arrests only within M's city limits. T, along with all other officers on the force, is ordinarily on duty for eight hours each work day and on call during the other sixteen hours. T is provided with the use of a clearly marked police vehicle in which T is required to commute to his home in city M. The police department's official policy regarding marked police vehicles prohibits personal use (other than commuting) of the vehicles outside the city limits. When not using the vehicle on the job, T uses the vehicle only for commuting, personal errands on the way between work and home, and personal errands within city M. All use of the vehicle by T conforms to the requirements of paragraph (k)(3) of this section. Therefore, the value of that use is excluded from T's gross income as a working condition fringe and the vehicle is not subject to the substantiation requirements of section 274(d).

(l) *Definitions.* For purposes of section 274(d) and this section, the terms "automobile" and "vehicle" have the same meanings as prescribed in §1.61-2T Q/A-11 and §1.61-2T Q/A-20, respectively. Also, for purposes of section 274(d) and this section, the terms "employer," "employee," and "personal use" have the same meanings as prescribed in §274-6T(e).

(m) *Effective date.* Section 274(d), as amended by the Tax Reform Act of 1984 and Public Law 99-44, and this section (except as provided in paragraph (d)(2) and (3) of this section) apply with respect the taxable years beginning after December 31, 1985. Section 274(d) and this section apply to any deduction or credit claimed in a taxable year beginning after December 31, 1985, with respect to any listed property, regardless of the taxable year in which the property was placed in service. However, except as provided in §1.132-1T Q/A-4b with respect to qualified nonpersonal use vehicles, the substantiation requirements of section 274(d) and this section do not apply to the determination of an employee's working condition fringe exclusion or to the determination under §1.162-25T(b) of an employee's deduction before the date that those requirements apply, under this paragraph (m), to the employer, if the employer is taxable.

Par. 7. New §1.274-6T is added immediately after §1.274-5T and reads as follows:

§1.274-6T Substantiation with respect to certain types of listed property for taxable years beginning after 1985 (temporary).

(a) *Written policy statements as to vehicles*—(1) *In general.* Two types of written policy statements satisfying the conditions described in paragraph (a)(2) and (3) of this section, if initiated and kept by an employer to implement a policy of no personal use, or no personal use except for commuting, of a vehicle provided by the employer, qualify as sufficient evidence corroborating the taxpayer's own statement and therefore will satisfy the employer's substantiation requirements under section 274(d). Therefore, the employee need not keep a separate set of records for purposes of the employer's substantiation requirements under section 274(d) with respect to use of a vehicle satisfying these written policy statement rules. A written policy statement adopted by a governmental unit as to employee use of its vehicles is eligible for these exceptions to the section 274(d) substantiation rules. Thus, a resolution of a city council or a provision of state law or a state constitution would qualify as a written policy statement, as long as the conditions described in paragraph (a)(2) and (3) of this section are met.

(2) *Vehicles not used for personal purposes*—(i) *Employers.* A policy statement that prohibits personal use by an employee satisfies an employer's substantiation requirements under section 274(d) if all the following conditions are met—

(A) The vehicle is owned or leased by the employer and is provided to one or more employees for use in connection with the employer's trade or business,

(B) When the vehicle is not used in the employer's trade or business, it is kept on the employer's business premises, unless it is temporarily located elsewhere, for example, for maintenance or because of a mechanical failure,

(C) No employee using the vehicle lives at the employer's business premises,

(D) Under a written policy of the employer, neither an employee, nor any individual whose use would be taxable to the employee, may use the vehicle for personal purposes, except for de minimis personal use (such as a stop for lunch between two business deliveries), and

(E) The employer reasonably believes that, except for de minimis use, neither the employee, nor any individual whose use would be taxable to the employee, uses the vehicle for any personal purpose.

There must also be evidence that would enable the Commissioner to determine whether the use of the vehicle meets the preceding five conditions.

(ii) *Employees.* An employee, in lieu of substantiating the business/investment use of an employer-provided vehicle under §1.274-5T, may treat all use of the vehicle as business/investment use if the following conditions are met—

(A) The vehicle is owned or leased by the employer and is provided to one or more employees for use in connection with the employer's trade or business,

(B) When the vehicle is not used in the employer's trade or business, it is kept on the employer's business premises, unless it is temporarily located elsewhere, for example, for maintenance or because of a mechanical failure,

(C) No employee using the vehicle lives at the employer's business

premises.

(D) Under a written policy of the employer, neither the employee, nor any individual whose use would be taxable to the employee, may use the vehicle for personal purposes, except for de minimis personal use (such as a stop for lunch between two business deliveries), and

(E) Except for de minimis personal use, neither the employee, nor any individual whose use would be taxable to the employee, uses the vehicle for any personal purpose.

There must also be evidence that would enable the Commissioner to determine whether the use of the vehicle meets the preceding five conditions.

(3) *Vehicles not used for personal purposes other than commuting*—(i) *Employers.* A policy statement that prohibits personal use by an employee, other than commuting, satisfies an employer's substantiation requirements under section 274(d) if all the following conditions are met—

(A) The vehicle is owned or leased by the employer and is provided to one or more employees for use in connection with the employer's trade or business and is used in the employer's trade or business,

(B) For bona fide noncompensatory business reasons, the employer requires the employee to commute to and/or from work in the vehicle,

(C) The employer has established a written policy under which neither the employee, nor any individual whose use would be taxable to the employee, may use the vehicle for personal purposes, other than for commuting or de minimis personal use (such as a stop for a personal errand on the way between a business delivery and the employee's home),

(D) The employer reasonably believes that, except for de minimis personal use, neither the employee, nor any individual whose use would be taxable to the employee, uses the vehicle for any personal purpose other than commuting,

(E) The employee required to use the vehicle for commuting is not a control employee (as defined in §1.61-2T Q/A-20b) required to use an automobile (as defined in §1.61-2T Q/A-11), and

(F) The employer accounts for the commuting use by including in the employee's gross income the commuting value provided in §1.61-2T Q/A-21 (to the extent not reimbursed by the employee).

There must be evidence that would enable the Commissioner to determine whether the use of the vehicle met the preceding six conditions.

(ii) *Employees.* An employee, in lieu of substantiating the business/investment use of an employer-provided vehicle under §1.274-5T, may substantiate any exclusion allowed under section 132 for a working condition fringe by including in income the commuting value of the vehicle (determined by the employer pursuant to §1.61-2T Q/A21) if all the following conditions are met:

(A) The vehicle is owned or leased by the employer and is provided to one or more employees for use in connection with the employer's trade or business and is used in the employer's trade or business,

(B) For bona fide noncompensatory business reasons, the employer requires the employee to commute to and/or from work in the vehicle,

(C) Under a written policy of the employer, neither the employee, nor any individual whose use would be taxable to the employee, may use the vehicle for personal purposes, other than for commuting or de minimis personal use (such as a stop for a personal errand on the way between a business delivery and the employee's home),

(D) Except for de minimis personal use, neither the employee, nor any individual whose use would be taxable to the employee, uses the vehicle for any personal purpose other than commuting,

(E) The employee required to use the vehicle for commuting is not a control employee (as defined in §1.61-2T Q/A-20b) required to use an automobile (as defined in §1.61-2T Q/A-11), and

(F) The employee includes in gross income the commuting value determined by the employer as provided in §1.61-2T Q/A-21)to the extent that the employee does not reimburse the employer for the commuting use).

There must also be evidence that would enable the Commissioner to determine whether the use of the vehicle met the preceding six conditions.

(b) *Vehicles used in connection with the business of farming*—(1) *In general.* If, during a taxable year or shorter period, a vehicle, not otherwise described in section 274(i), §1.274-5T (k), or paragraph (a)(2) or (3) of this section, is owned or leased by an employer and used during most of a normal business day directly in connection with the business of farming (as defined in paragraph (b)(2) of this section), the employer, in lieu of substantiating the use of the vehicle as prescribed in §1.274-5T(b)(6)(i)(B), may determine any deduction or credit with respect to the vehicle as if the business/investment use (as defined in §1.280F-6T(d)(3)(i)) and the qualified business use (as defined in §1.280F-6T(d)(2)) of the vehicle in the business of farming for the taxable year or shorter period were 75 percent plus that percentage, if any, attributable to an amount included in an employee's gross income. If the vehicle is also available for personal use by employees, the employer must include the value of that personal use in the gross income of the employees, allocated among them in the manner prescribed in §1.132-1T Q/A-4a(f).

(2) *Directly in connection with the business of farming.* The phrase "directly in connection with the business of farming" means that the vehicle must be used directly in connection with the business of operating a farm (i.e., cultivating land or raising or harvesting any agricultural or horticultural commodity, or the raising, shearing, feeding, caring for, training, and management of animals) or incidental thereto (for example, trips to the feed and supply store).

(3) *Substantiation by employees.* If an employee is provided with the use of a vehicle to which this paragraph (b) applies, the employee may, in lieu of substantiating the business/investment use of the vehicle in the manner prescribed in §1.274-5T, substantiate any exclusion allowed under section 132 for a working condition fringe as if the business/investment use of the vehicle were 75 percent, plus that percentage, if any, determined by the employer to be attributable to the use of the vehicle by individuals other than the employee, provided that the employee includes in gross income the amount determined by

the employer as includible in the employee's gross income. *See* §1.132-1T Q/A-4a (f) for examples illustrating the allocation of use of a vehicle among employees.

(c) *Vehicles treated as used entirely for personal purposes.* An employer may satisfy the substantiation requirements under section 274(d) for a taxable year or shorter period with respect to the business use of a vehicle that is provided to an employee by including the value of the availability of the vehicle during the relevant period in the employee's gross income without any exclusion for a working condition fringe with respect to the vehicle and, if required, by withholding any taxes. Under these circumstances, the employer's business/investment use of the vehicle during the relevant period is 100 percent. The employer's qualified business use of the vehicle is dependent upon the relationship of the employee to the employer (*see* §1.280F-6T(d)(2)).

(d) *Limitation.* If a taxpayer chooses to satisfy the substantiation requirements of section 274(d) and §1.274-5T by using one of the methods prescribed in paragraphs (a)(2) or (3), (b), or (c) of this section and files a return with the Internal Revenue Service for a taxable year consistent with such choice, the taxpayer may not later use another of these methods. Similarly, if a taxpayer chooses to satisfy the substantiation requirements of section 274(d) in the manner prescribed in §1.274-5T and files a return with the Internal Revenue Service for a taxable year consistent with such choice, the taxpayer may not later use a method prescribed in paragraph (a)(2) or (3), (b), or (c) of this section. This rule applies to an employee for purposes of substantiating any working condition fringe exclusion as well as to an employer. For example, if an employee excludes on his federal income tax return for a taxable year 90 percent of the value of the availability of an employer-provided automobile on the basis of records that allegedly satisfy the "adequate records" requirement of §1.274-5T(c)(2), and that requirement is not satisfied, then the employee may not satisfy the substantiation requirements of section 274(d) for the taxable year by any method prescribed in this section, but may present other corroborative evidence as prescribed in §1.274-5T(c)(3).

(e) *Definitions*—(1) *In general.* The definitions provided in this paragraph (e) apply for purposes of section 274(d), §1.274-5T, and this section.

(2) *Employer and employee.* The terms "employer" and "employee" include the following:

(i) A sole proprietor shall be treated as both an employer and employee,

(ii) A partnership shall be treated as an employer of its partners, and

(iii) A partner shall be treated as an employee of the partnership.

(3) *Automobile.* The term "automobile" has the same meaning as prescribed in §1.61-2T Q/A-11.

(4) *Vehicle.* The term "vehicle" has the same meaning as prescribed in §1.61-2T Q/A-20.

(5) *Personal use.* "Personal use" by an employee of an employer-provided vehicle includes use in any trade or business other than the trade or business of being the employee of the employer providing the vehicle.

(f) *Effective date.* This section is effective for taxable years beginning after December 31, 1985.

Par. 8. Section 1.280F-1T is amended by adding a new paragraph (c)(3) to read as follows:

§1.280F-1T Limitations on investment tax credit and recovery deductions under section 168 for passenger automobiles and certain other listed property; overview of regulations (temporary).

* * * * *

(c) *Effective dates*—* * *

(3) *Leased passenger automobiles.* Section 1.280F-5T(e) generally applies to passenger automobiles leased after April 2, 1985, in taxable years ending after that date. Section 1.280F-5T(e) does not apply to any passenger automobile that is leased pursuant to a binding contract, which is entered into no later than April 2, 1985, and which is in effect at all times thereafter, but only if the automobile is used under the lease before August 1, 1985. If §1.280F-5T(e) does not apply to a passenger automobile, *see* paragraph (c)(1) and (2) of this section.

Par. 9. Section 1.280F-3T is amended by revising the first sentence of paragraph (d)(3) to read as follows: "A taxpayer must be able to substantiate the use of any listed property, as prescribed in section 274(d)(4) and §1.274-5T or §1.274-6T, for any taxable year for which recapture under section 280F(b)(3) and paragraph (d)(1) and (2) of this section may occur even if the taxpayer has fully depreciated (or expensed) the listed property in a prior year."

Par. 10. Section 1.280F-5T is amended as follows:

1. The Caption of paragraph (d) and the first sentence of paragraph (d)(1) are revised to read as set forth below.

2. The first sentence of paragraph (d)(2)(i) is amended by adding after the words "passenger automobile" the clause ", which is leased after June 18, 1984, and before April 3, 1985,".

3. Paragraph (d)(2)(ii) is amended by removing the words "paragraph (g)(2)" and "paragraph (g)(3)" wherever they appear and by adding in their places the words "paragraph (h)(2)" and "paragraph (h)(3)", respectively. Paragraph (d)(2)(ii) is further amended by removing the words "paragraph (d)(3)(iii)" and "paragraph (d)(3)(iv)" and by adding in their places the words "paragraph (d)(2)(iii)" and "paragraph (d)(2)(iv)", respectively.

4. Paragraphs (e), (f), (g), and (h) are redesignated as paragraphs (f), (g), (h), and (i).

5. A new paragraph (e) is added immediately after paragraph (d) and reads as set forth below.

6. Paragraph (f) as redesignated is amended by removing from paragraph (f)(2)(i) the words "paragraph (g)(2)" and by adding in their place the words "paragraph (h)(2)", by removing from paragraph (f)(2)(ii) the words "paragraph (g)(3)" and by adding in their place the words "paragraph (h)(3)", and by removing from paragraph (f)(2)(iii) the words "paragraph (e)(3)" and by adding in their place the words "paragraph (f)(3)".

7. The first sentence of paragraph (g) as redesignated is revised to read as set forth below.

8. Paragraph (g)(2) as redesignated is amended by removing the words "paragraph (f)(2)" and by adding in their place the words "paragraph (g)(2)".

9. The sentence of paragraph (h)(3) as redesignated is amended by

removing the words "paragraph (f)(1)" and by adding in their place the words "paragraph (g)(1)".

10. Example (3) of paragraph (i) as redesignated is amended by removing from the fourth sentence the words "paragraphs (e)(1) and (f)(1)", "paragraph (f)(3)", and "paragraph (e)(3)(ii)", and by adding in their places the words "paragraphs (f)(1) and (g)(1)", "paragraph (g)(3)", and "paragraph (f)(3)(ii)", respectively.

11. Example (4) of the paragraph (i) as redesignated is amended by removing from the third sentence the words "paragraphs (e)(1) and (f)(1) and (2)", "paragraph (f)(3)", and "paragraph (e)(3)(i)", and by adding in their places the words "paragraphs (f)(1) and (g)(1) and (2)", "paragraph (g)(3)", and "paragraph (f)(3)(i)", respectively.

12. Paragraph (i) as redesignated is further amended by adding after example (4) two new examples to read as set forth below.

13. The new and revised provisions read as follows:

§1.280F-5T Leased property (temporary).

* * * * *

(d) *Inclusions in income of lessees of passenger automobiles leased after June 18, 1984, and before April 3, 1985*—(1) *In general.* If a taxpayer leases a passenger automobile after June 18, 1984, but before April 3, 1985, for each taxable year during which the taxpayer leases the automobile, the taxpayer must include in gross income an inclusion amount (prorated for the number of days of the lease term included in that taxable year), determined under this paragraph (d)(1), and multiplied by the business/investment use (as defined in §1.280F-6T(d)(3)(i)) for the particular taxable year. * * *

(e) *Inclusions in income of lessees of passenger automobiles leased after April 2, 1985*—(1) *In general.* For any passenger automobile that is leased after April 2, 1985, the inclusion amount for each taxable year during which an automobile is leased is based on the rules set forth in this paragraph (e). Additional inclusion amounts when a passenger automobile is not used predominantly in a qualified business use during a taxable year are determined under paragraph (e)(6) of this section. *See* paragraph (h)(2) of this section for the definition of fair market value.

(2) *Fair market value not greater than $50,000: years one through three.* For any passenger automobile that has a fair market value not greater than $50,000, the inclusion amount for each of the first three taxable years during which the automobile is leased is determined as follows:

(i) For the appropriate range of fair market values in the table in paragraph (e)(2)(iv) of this section, select the dollar amount from the column for the quarter of the taxable year in which the automobile is first used under the lease.

(ii) Prorate the dollar amount for the number of days of the lease term included in the taxable year, and

(iii) Multiply the prorated dollar amount by the business/investment use for the taxable year.

(iv) *DOLLAR AMOUNTS: YEARS 1–3*

Fair Market Value		*Taxable year quarter*			
		Fourth	*Third*	*Second*	*First*
Greater than	But not greater than				
$11,250	$11,500	$ 8	$ 7	$ 6	$ 6
11,500	11,750	24	21	19	17
11,750	12,000	40	35	32	29
12,000	12,250	56	49	44	40
12,250	12,500	72	64	57	52
12,500	12,750	88	78	70	63
12,750	13,000	104	92	83	75
13,000	13,250	120	106	95	86
13,250	13,500	144	128	115	104
13,500	13,750	172	153	137	124
13,750	14,000	200	177	159	145
14,000	14,250	228	202	182	165
14,250	14,500	256	227	204	185
14,500	14,750	284	252	226	206
14,750	15,000	312	277	249	226
15,000	15,250	340	302	271	246
15,250	15,500	369	327	293	266
15,500	15,750	397	352	316	287
15,750	16,000	425	377	338	307
16,000	16,250	453	402	360	327
16,250	16,500	481	426	383	348
16,500	16,750	509	451	405	368
16,750	17,000	537	476	428	388
17,000	17,500	579	514	461	419
17,500	18,000	635	563	506	459
18,000	18,500	691	613	550	500
18,500	19,000	748	663	595	541
19,000	19,500	804	713	640	581
19,500	20,000	860	763	685	622
20,000	20,500	916	812	729	662
20,500	21,000	972	862	774	703
21,000	21,500	1028	912	819	744
21,500	22,000	1084	962	863	784
22,000	23,000	1169	1036	930	845
23,000	24,000	1281	1136	1020	926
24,000	25,000	1393	1236	1109	1007
25,000	26,000	1506	1335	1199	1089
26,000	27,000	1618	1435	1288	1170
27,000	28,000	1730	1534	1377	1251
28,000	29,000	1842	1634	1467	1332

Fair Market Value		Taxable year quarter			
		Fourth	*Third*	*Second*	*First*
Greater than	But not greater than				
29,000	30,000	1955	1734	1556	1413
30,000	31,000	2067	1833	1646	1495
31,000	32,000	2179	1933	1735	1576
32,000	33,000	2292	2032	1824	1657
33,000	34,000	2404	2132	1914	1738
34,000	35,000	2516	2232	2003	1819
35,000	36,000	2629	2331	2093	1901
36,000	37,000	2741	2431	2182	1982
37,000	38,000	2853	2530	2271	2063
38,000	39,000	2965	2630	2361	2144
39,000	40,000	3078	2730	2450	2225
40,000	41,000	3190	2829	2540	2307
41,000	42,000	3302	2929	2629	2388
42,000	43,000	3415	3028	2718	2469
43,000	44,000	3527	3128	2808	2550
44,000	45,000	3639	3228	2897	2631
45,000	46,000	3752	3327	2987	2713
46,000	47,000	3864	3427	3076	2794
47,000	48,000	3976	3526	3165	2875
48,000	49,000	4088	3626	3255	2956
49,000	50,000	4201	3726	3344	3037

(3) *Fair market value not greater than $50,000: years four through six.* For any passenger automobile that has a fair market value greater than $18,000, but not greater than $50,000, the inclusion amount for the fourth, fifth, and sixth taxable years during which the automobile is leased is determined as follows:

(i) for the appropriate range of fair market values in the table in paragraph (e)(3)(iv) of this section, select the dollar amount from the column for the taxable year in which the automobile is used under the lease,

(ii) Prorate the dollar amount for the number of days of the lease term included in the taxable year, and

(iii) Multiply this dollar amount by the business/investment use for the taxable year.

(iv) *DOLLAR AMOUNTS: YEARS 4–6*

Fair Market Value		*Year 4*	*Year 5*	*Year 6*
Greater than	But not greater than			
$18,000	$18,500	$ 15	—	—
18,500	19,000	45	—	—
19,000	19,500	75	—	—
19,500	20,000	105	—	—
20,000	20,500	135	—	—
20,500	21,000	165	—	—
21,000	21,500	195	—	—
21,500	22,000	225	—	—
22,000	23,000	270	—	—
23,000	24,000	330	$ 42	—
24,000	25,000	390	102	—
25,000	26,000	450	162	—
26,000	27,000	510	222	—
27,000	28,000	570	282	—
28,000	29,000	630	342	$ 54
29,000	30,000	690	402	114
30,000	31,000	750	462	174
31,000	32,000	810	522	234
32,000	33,000	870	582	294
33,000	34,000	930	642	354
34,000	35,000	990	702	414
35,000	36,000	1050	762	474
36,000	37,000	1110	822	534
37,000	38,000	1170	882	594
38,000	39,000	1230	942	654
39,000	40,000	1290	1002	714

Fair Market Value		Year 4	Year 5	Year 6
Greater than	But not greater than			
40,000	41,000	1350	1062	774
41,000	42,000	1410	1122	834
42,000	43,000	1470	1182	894
43,000	44,000	1530	1242	954
44,000	45,000	1590	1302	1014
45,000	46,000	1650	1362	1074
46,000	47,000	1710	1422	1134
47,000	48,000	1770	1482	1194
48,000	49,000	1830	1542	1254
49,000	50,000	1890	1602	1314

(4) *Fair market value greater than $50,000: years one through six.* (i) For any passenger automobile that has a fair market value greater than $50,000, the inclusion amount for the first six taxable years during which the automobile is leased is determined as follows:

(A) Determine the dollar amount by using the appropriate formula in paragraph (e)(4)(ii) of this section,

(B) Prorate the dollar amount for the number of days of the lease term included in the taxable year, and

(C) Multiply this dollar amount by the business/investment use for the taxable year.

(ii) The dollar amount is computed as follows:

(A) If the automobile is first used under the lease in the fourth quarter of a taxable year, the dollar amount for each of the first three taxable years during which the automobile is leased is the sum of—

(1) $124, and

(2) 11 percent of the excess of the automobile's fair market value over $13,200.

(B) If the automobile is first used under the lease in the third quarter of a taxable year, the dollar amount for each of the first three taxable years during which the automobile is leased is the sum of—

(1) $110, and

(2) 10 percent of the excess of the automobile's fair market value over $13,200.

(C) If the automobile is first used under the lease in the second quarter of a taxable year, the dollar amount for each of the first three taxable years during which the automobile is leased is the sum of—

(1) $100, and

(2) 9 percent of the excess of the automobile's fair market value over $13,200.

(D) If the automobile is first used under the lease in the first quarter of a taxable year, the dollar amount for each of the first three taxable years during which the automobile is leased is the sum of—

(1) $90, and

(2) 8 percent of the excess of the automobile's fair market value over $13,200.

(E) For the fourth taxable year during which the automobile is leased, the dollar amount is 6 percent of the excess of the automobile's fair market value over $18,000.

(F) For the fifth taxable year during which the automobile is leased, the dollar amount is 6 percent of the excess of the automobile's fair market value over $22,800.

(G) For the sixth taxable year during which the automobile is leased, the dollar amount is 6 percent of the excess of the automobile's fair market value over $27,600.

(5) *Seventh and subsequent taxable years.* (i) For any passenger automobile that has a fair market value less than or equal to $32,400, the inclusion amount for the seventh and subsequent taxable years during which the automobile is leased is zero.

(ii) For any passenger automobile that has a fair market value greater than $32,400, the inclusion amount for the seventh and subsequent taxable years during which the automobile is leased is 6 percent of—

(A) The excess (if any) of the automobile's fair market value, over

(B) The sum of—

(1) $13,200 and

(2) $4,800 multiplied by the number of taxable years in excess of three years.

(6) *Additional inclusion amount when less than predominant use in a qualified business use.* (i) If a passenger automobile, which is leased after April 2, 1985, is not predominantly used in a qualified business use during a taxable year, the lessee must add to gross income in the first taxable year that the automobile is not so used (and only in that year) an inclusion amount determined under this paragraph (e)(6). This inclusion amount is in addition to the amount required to be included in gross income under paragraph (e)(2), (3), (4), and (5) of this section.

(ii) If the fair market value (as defined in paragraph (h)(2) of this section) of the automobile is greater than $11,250, the inclusion amount is determined by multiplying the average of the business/investment use (as defined in paragraph (h)(3) of this section) by the appropriate dollar amount from the table in paragraph (e)(6)(iii) of this section. If the fair market value of the automobile is $11,250 or less, the inclusion amount is the product of the fair market value of the automobile, the average business/investment use, and the applicable percentage from the table in paragraph (e)(6)(iv) of this section.

(iii) The dollar amount is determined under the following table:

If a passenger automobile is not predominantly used in a qualified business use during—	*The dollar amount is: Lease Term (years)*			
	1	*2*	*3*	*4 or more*
The first taxable year of the lease term	$350	$700	$1150	$1500
The second taxable year of the lease term	—	150	700	1200
The third taxable year of the lease term	—	—	250	750

(iv) The applicable percentage is determined under the following table:

If a passenger automobile is not predominantly used in a qualified business use during—	*The applicable percentage Lease Term (years)*			
	1	*2*	*3*	*4 or more*
The first taxable year of the lease term	3.0	6.0	10.2	13.2
The second taxable year of the lease term		1.25	6.2	10.4
The third taxable year of the lease term			2.25	6.5
The fourth taxable year of the lease term				1.7
The fifth taxable year of the lease term				0.5

* * * * *

(g) *Special rules applicable to inclusions in income of lessees.* This paragraph (g) applies to the inclusions in gross income of lessees prescribed under paragraphs (d)(2), (e)(6), or (f) of this section.

* * * * *

(i) *Examples.* * * *

Example (5) On July 15, 1985, A, a calendar year taxpayer, leases and places in service a passenger automobile with a fair market value of $45,300. The lease is for a period of 5 years, during which A uses the automobile exclusively in a trade or business. Under paragraph (e)(2) and (3) of this section, for taxable years 1985 through 1990, A must include the following amounts in gross income:

Taxable year	*Dollar amount*	*Proration*	*Business use*	*Inclusion*
1985	$3327	170/365	100%	$1550
1986	3327	365/365	100%	3327
1987	3327	365/365	100%	3327
1988	1650	366/366	100%	1650
1989	1362	365/365	100%	1362
1990	1074	196/365	100%	577

Example (6) The facts are the same as in example (1), except that A uses the automobile only 45 percent in a trade or business during 1987 through 1990. Under §1.280F-5T(e)(6), A must include in gross income for taxable year 1987, the first taxable year in which the automobile is not used predominantly in a trade or business, an additional amount based on the average business/investment use for taxable years 1985 through 1987. For taxable years 1985 through 1990, A must include the following amounts in gross income:

Taxable year	*Dollar amount*	*Proration*	*Business use*	*Inclusion*
1985	$3327	170/365	100%	$1550
1986	3327	365/365	100%	3327
1987	3327	365/365	45%	1497
	750		81.67%	612
1988	1650	366/366	45%	743
1989	1362	365/365	45%	613
1990	1074	196/365	45%	260

Par. 11. Section 1.280F-6T is amended by revising paragraphs (b)(2)(ii) and (b)(3) to read as follows:

§1.280F-6T Special rules and definitions (temporary).

* * * * *

(b) * * *

(2) * * *

(ii) *Exception.* The term "listed property" does not include any vehicle that is a qualified nonpersonal use vehicle as defined in section 274(i) and §1.274-5T(k).

(3) *Property used for entertainment, etc.*—(i) *In general.* Property of a type generally used for purposes of entertainment, recreation, or amusement includes property such as photographic, phonographic, communication, and video recording equipment.

(ii) *Exception.* The term "listed property" does not include any photographic, phonographic, communication, or video recording equipment of a taxpayer if the equipment is used either exclusively at the taxpayer's regular business establishment or in connection with the taxpayer's principal trade or business.

(iii) *Regular business establishment.* The regular business establishment of an employee is the regular business establishment of the employer of the employee. For purposes of this paragraph (b)(3), a portion of a dwelling unit is treated as a regular business establishment if the requirements of section 280A(c)(1) are met with respect to that portion.

* * * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 12. The authority citation for Party 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 13. Section 602.101(c) is amended by inserting in the appropriate places in the table

"§1.61-2T Q/A-20 . 1545-0771",

"§1.274-5T ..... 1545-0771", and

"§1.274-6T ..... 1545-0771".

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved October 29, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

Section 280F.—Limitation on Investment Tax Credit and Depreciation for Luxury Automobiles; Limitation Where Certain Property Used for Personal Purposes

26 CFR 1.280F-1T: Limitations on investment tax credit and recovery deductions under section 168 for passenger automobiles and certain other listed property; overview of regulations (temporary).

Effective dates for limitations on investment tax credit and depreciation for leased passenger automobiles. See T.D. 8061, page 93.

Section 280G.—Golden Parachute Payments

What are the applicable federal rates to be used for purposes of section 280G? See Rev. Rul 85-170, page 186.

Subchapter C.—Corporate Distributions and Adjustments
Part I.—Distributions by Corporations
Subpart A.—Effects on Recipients

Section 302.—Distributions in Redemption of Stock

26 CFR 1.302-2: Redemptions not taxable as dividends.

Redemption of stock; effect of retained common stock on redemption of nonvoting preferred stock. When a trust directly and by attribution holds common stock and preferred stock and is one of three shareholders capable of forming a control group, a redemption of a portion of the trust's nonvoting preferred stock fails to qualify as a redemption that is not essentially equivalent to a dividend within the meaning of section 302(b)(1) of the Code.

Rev. Rul. 85-106

ISSUE

Is a redemption of nonvoting preferred stock not essentially equivalent to a dividend within the meaning of section 302(b)(1) of the Internal Revenue Code when there is no reduction in the percentage of voting and nonvoting common stock owned by the redeemed shareholder, and when the redeemed shareholder continues to have an undiminished opportunity to act in concert with other shareholders as a control group, under the circumstances described below?

FACTS

Corporation *X* had outstanding three classes of stock consisting of 100 shares of voting common stock, 100 shares of nonvoting common stock, and 50 shares of nonvoting 9 percent cumulative preferred stock. The fair market value of each share of common stock was approximately half the fair market value of each share of preferred stock. The voting common stock was held as follows:

Shareholders	*Shares*
A	19
B	19
C	18
Minority shareholders	44
Total	100

None of the minority shareholders owned more than five shares. None of the holders of the voting common stock were related within the meaning of section 318(a) of the Code. The combined voting power of *A*, *B*, and *C* was sufficient to elect a majority of the board of directors of *X*.

The nonvoting common stock and the preferred stock were held (directly and indirectly) in approximately the same proportions as the common stock. *C* held no nonvoting common stock or preferred stock directly, but was the sole remaining beneficiary of a trust, *T*, which owned 18 percent of both the nonvoting common stock and the preferred stock.

The trustees of *T* decided that it would be in the best interests of that trust if most of the *X* preferred stock held by *T* could be converted into cash. After negotiation, *X* redeemed six shares of preferred stock for its fair market value of 6x dollars. Following this redemption, *T* continued to hold three shares of preferred stock, and 18 percent of the nonvoting common stock. Under section 318(a)(3)(B) of the Code, *T* is also considered to own the voting common stock owned by its sole beneficiary, *C*.

LAW AND ANALYSIS

Section 302(a) of the Code provides, in part, that if a corporation redeems its stock, and if section 302(b)(1), (2), (3), or (4) applies, such redemption will be treated as a distribution in part or full payment in exchange for the stock.

Section 302(b)(1) of the Code provides that section 302(a) will apply if the redemption is not essentially equivalent to a dividend. Section 302(b)(2) provides that section 302(a) will apply if (in addition to other requirements) the redemption substantially reduces the voting power of the shareholder. Section 302(b)(3) provides that section 302(a) will apply if the redemption completely terminates the shareholder's interest in the corporation. Section 302(b)(4) does not deal with the type of redemption under consideration. Section 302(c)(1) provides, with an exception not here relevant, that the constructive ownership rules of section 318(a) apply in determining the ownership of stock for purposes of section 302.

The lack of any reduction in *T*'s 18 percent vote prevented this redemption from qualifying under section 302(b)(2) of the Code, and the lack of complete termination of interest prevented it from qualifying under section 302(b)(3). The question remains whether the redemption should be considered not essentially equivalent to a dividend so as to qualify under section 302(b)(1). Under section 1.302-2(b) of the Income Tax Regulations, this determination depends upon the facts and circumstances of each case.

In United States v. Davis, 397 U.S. 301 (1970), 1970-1 C.B. 62, the Supreme Court of the United States held that in order to qualify under section 302(b)(1) of the Code, a redemption must result in a meaningful reduction of the shareholder's proportionate interest in the corporation, and that, for this purpose, the attribution rules of section 318 apply.

In determining whether a reduction in interest is "meaningful", the rights inherent in a shareholder's interest must be examined. The three elements of a shareholder's interest that are generally considered most significant are: (1) the right to vote and thereby exercise control; (2) the right to participate in cur-

rent earnings and accumulated surplus; and (3) the right to share in net assets on liquidation. Rev. Rul. 81-289, 1981-2 C.B. 82.

In applying the above principles, it is significant that (as a result of section 318(a)(3)(B) of the Code) the redemption did not reduce *T*'s percentage of the vote in *X*. It is true that *T* reduced its percentage interest in current earnings, accumulated surplus, and net assets upon liquidation, and reduced the fair market value of its ownership in *X*. However, when the redeemed shareholder has a voting interest (either directly or by attribution), a reduction in voting power is a key factor in determining the applicability of section 302(b)(1) of the Code. *Johnson Trust v. Commissioner*, 71 T.C. 941, 947, 948 (1979). Rev. Rul. 78-401, 1978-2 C.B. 127; Rev. Rul. 77-218, 1977-1 C.B. 81; Rev. Rul. 7-502, 1975-2 C.B. 111; Rev. Rul. 75-512, 1975-2 C.B. 112.

It is also true that *T* was not the largest shareholder. *A* and *B* each held slightly larger voting interests, and larger interests measured by fair market value. *T*, however, was not in the position of a minority shareholder isolated from corporate management and control. Compare Rev. Rul. 75-512, where the majority of the redeeming corporation's voting stock was held by a shareholder unrelated (within the meaning of section 318(a)) to the redeemed trust. Also compare Rev. Rul. 76-385, 1976-2 C.B. 92, where the redeemed shareholder's total interest was *de minimis*.

In the present situation, a significant aspect of *T*'s failure to reduce voting power is the fact that the redemption leaves unchanged *T*'s potential (by attribution from *C*) for participating in a control group by acting in concert with *A* and *B*. Compare Rev. Rul. 76-364, 1976-2 C.B. 91, where a reduction in voting interest was found meaningful in itself when it caused the redeemed shareholder to give up a potential for control by acting in concert with one other shareholder. In addition, the Tax Court has indicated significance for this factor of potential group control (*Johnson Trust*, at 947). See also *Bloch v. United States*, 261 F. Supp. 597, 611-612 (S.D. Tex. 1966), *aff'd per curiam*, 386 F. 2d 839 (5th Cir. 1967), where, in finding that "the distributions in question were essentially equivalent to a dividend," the court noted that there was no change in the redeemed shareholder's potential for exercising control "by aligning himself with one or more of the other stockholders."

Although there was a reduction of *T*'s economic interest in *X*, such reduction was not sufficiently large to result in a meaningful reduction of *T*'s interest. The absence of any reduction of *T*'s voting interest in *X* (through *C*) and *T*'s potential (through *C*) for control group participation are compelling factors in this situation.

In *Himmel v. Commissioner*, 338 F.2d 815 (2d Cir. 1964), dealing with a similar question, a decision was reached permitting the applicability of section 302(b)(1) of the Code. That case, however, was decided prior to the decision of the Supreme Court in *Davis*. Thus, *Himmel* fails to reflect the development in the law represented by the *Davis* limitation on section 302(b)(1) applicability where there is no meaningful reduction of the shareholder's proportionate interest in the corporation. Thus, pursuant to *Davis*, it is proper to view *Himmel* as incorrect to the extent it conflicts with the position contained in this revenue ruling.

HOLDING

The redemption of nonvoting preferred stock held by *T* does not qualify as a redemption under section 302(b)(1) of the Code, under the facts of this ruling when there is no reduction in the percentage of voting and nonvoting common stock owned by *T*, and when *T* continuous to have an undiminished opportunity to act in concert with other shareholders as a control group. Since the redemption does not otherwise qualify under section 302(b), it is not a distribution in part or full payment for the stock under section 302(a). Consequently, under section 302(d), the redemption will be treated as a distribution of property to which section 301 applies.

Section 351.—Transfer to Corporation Controlled by Transferor

How does corporation that uses dollar-value last-in, first-out (LIFO) inventory method and that transfers a portion of its inventories in a nontaxable exchange under section 351 compute its basis in the inventories transferred. See Rev. Rul. 85-176, page 159.

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26 CFR 1.351-1: Transfer to corporation controlled by transferor.
(Also Sections 358, 1223; 1.358-2, 1.1223-1.)

Controlled corporation; transfers of property with varying bases and holding periods. The aggregate basis of different assets transferred to a controlled corporation in an exchange that meets the requirements of section 351 of the Code is allocated among the stock and the securities received in the exchange in proportion to the fair market values of the stock and the securities, under sections 1.358-1 and 1.358-2(b)(2) of the regulations. The stock and the securities have split holding periods for purposes of determining long-term or short-term capital gain or loss. Rev. Ruls. 62-140 and 68-55 amplified.

Rev. Rul. 85-164

ISSUE

May a transferor determine the bases and holding periods of stock and securities received in a transfer under section 351 of the Internal Revenue Code by designating the specific property to be exchanged for particular stock or securities?

FACTS

A, an individual, was engaged in a business as a sole proprietor. The assets of the sole proprietorship consisted of trade accounts receivable with an adjusted basis of zero and a fair market value of 60*x* dollars, machinery with an adjusted basis of 5*x* dollars and a fair market value of 10*x* dollars, and real estate (land and building) with an adjusted basis of 25*x* dollars and a fair market value of 30*x* dollars. *A* had held the real estate and machinery for over one year. Both the real estate and machinery were property described in section 1231 of the Code.

In order to limit personal liability, *A* transferred all of the assets associated with the sole proprietorship to a new

corporation, *Y*, in exchange for all of *Y*'s stock and securities. *A* transfered the accounts receivable to *Y* in exchange for 100 shares of common stock, the fair market value of which was 60*x* dollars. *A* transferred the machinery and real estate to *Y* in exchange for the securities, which had a principal amount and a fair market value of 40*x* dollars. The selection of specific items for exchange was made to allocate assets with a high basis and long-term holding period to the securities.

LAW AND ANALYSIS

Section 351(a) of the Code provides that no gain or loss will be recognized if property is transferred to a corporation by a person solely in exchange for stock or securities in such corporation and immediately after the exchange such person is in control (as defined in section 368(c)) of the corporation.

Section 358(a)(1) of the Code and section 1.358-1 of the Income Tax Regulations provide that in the case of an exchange to which section 351 applies in which only non-recognition property is received, the basis of all of the stock and securities received in the exchage shall be the same as the basis of all property exchanged therefor. Section 358(b)(1) directs that, under regulations prescribed by the Secretary, the basis determined under subsection (a)(1) shall be allocated among the properties permitted to be received without the recognition of gain or loss.

Section 1.358-2(a) of the regulations prescribes rules for the allocation of basis among nonrecognition property received in corporate reorganization exchanges governed by sections 354, 355, 356 and 371(b). In general, these rules allow limited tracing of the basis of old stock or securities into new only with respect to (i) persons who owned stock or securities of more than one class, or both stock and securities, before the exchange and (ii) corporate recapitalizations under section 368(a)(1)(E). In all other cases, including exchanges under section 351, section 1.358-2(b)(2) provides that the basis of property transferred shall be allocated among all the stock and securities received in proportion to the fair market values of the stock of each class and the securities of each class.

Section 1223(1) and section 1.1223-1(a) of the regulations require that, in determining the period for which a taxpayer has held property received in an exchange, there shall be included the period for which he held the property exchanged if (i) in the taxpayer's hands the property received has the same basis in whole or in part as the property exchanged and (ii) for exchanges after March 1, 1954, the property exchanges was at the time of exchange a capital asset as defined in section 1221 or property used in a trade or business as described in section 1231.

Rev. Rul. 62-140, 1962-2 C.B. 181, holds that a share of stock received in exchange for a debenture and a cash payment had a split holding period. The portion of each share received attributable to ownership of the debenture was treated as including the period for which the taxpayer held the debenture and the portion of each share received attributable to the cash payment was treated as held beginning with the data following the date of acquisition.

Rev. Rul. 68-55, 1968-1 C.B. 140, holds that when property is transferred to a corporation under section 351(a) of the Code each asset must be considered transferred separately in exchange for a proportionate share of each of the various categories of the total consideration received.

In the instant case, *A* formed *Y* by transferring all of the business assets of the sole proprietorship to *Y* in exchange solely for all of *Y*'s stock and securities. *Y* will continue to carry on the business that *A* conducted, and *A* will remain in control of *Y*. The transfer, therefore, is subject to section 351 of the Code, with the bases and holding periods of the *Y* stock and securities in the hands of *A* determined under sections 358 and 1223 of the Code respectively.

HOLDING

A may not determine the bases and holding periods of the *Y* stock and securities received by designating specific property to be exchanged for particular stock or securities. Under sections 1.358-1 and 1.358-2(b)(2) of the regulations, the aggregate basis of the property transferred is allocated among the stock and the securities received in proportion to the fair market values of each class. The holding period of the *Y* stock and securities received by *A* is determined by referring to the assets deemed exchanged for each portion of the stock and securities. The aggregate basis of the property transferred was 30*x* dollars. Since the stock and securities *A* received had fair market values of 60*x* dollars and 40*x* dollars, respectively, a basis of 18*x* dollars (60*x*/100*x* × 30*x*) is allocated to the *Y* stock received by *A*, and a basis of 12*x* dollars (40*x*/100*x* × 30*x*) is allocated to the *Y* securities received. In addition, each share of *Y* stock and each security received by *A* has a split holding period and a split basis for purposes of determining long-term or short-term capital gain or loss. That fraction of each share of *Y* stock or security attributable to the real estate and machinery (40*x*/100*x*) is traded as including the period (over one year) for which *A* held the real estate and machinery and has a basis solely attributable to the real estate and machinery (*e.g.*, the 40*x*/100*x* of each share of stock attributable to the real estate and machinery will have a basis of .18*x* dollars (18*x*/100 shares)). The fraction of each share of *Y* stock or security attributable to the accounts receivable (60*x*/100*x*) has a holding period beginning on the day after the exchange and has a zero basis. If part or all of the stock or securities received in the exchange is disposed of at a time when the split holding period is relevent in determining tax liability, the same fractions will be applied to apportion the amount realized among the above components of the stock or security.

This holding would be unaffected if *A* were to make a transfer in exchange for securities at separate times, and the transfers were part of a single integrated transaction.

EFFECT ON OTHER REVENUE RULINGS

Rev. Ruls. 68-55 and 62-140 are amplified.

Subpart B—Effects on Shareholders and Security Holders

Section 355.—Distribution of Stock and Securities of a Controlled Corporation

26 CFR 1.355-2: Limitations.

Controlled corporation; stock distribution; business purpose. The busi-

ness purpose requirement under section 355 of the Code is met if an unprofitable ski resort is separated from a profitable golf and tennis resort in order to meet the recommendation of the securities underwriter who plans to market debentures of the profitable golf and tennis resort.

Rev. Rul. 85-122

ISSUE

Is the business purpose requirement of section 1.355-2(c) of the Income Tax Regulations met when stock of a controlled corporation is distributed under the circumstances described?

FACTS

P is a closely held corporation that owns and operates a golf and tennis resort in State *A*. *P* has for more than 5 years owned all the stock of *S*, a corporation that owns and operates a ski resort in State *B*. The golf and tennis resort operated by *P*, although profitable, is in need of substantial amounts of additional working capital to finance operation adequately. Due to various factors, including poor weather conditions, the ski resort operated by *S* has been experiencing significant losses for several years, and *S* is nearly bankrupt.

It is desired to sell *P* debentures in order to obtain additional working capital for *P*. *P* has approached an underwriter to explore debt financing through a private placement of its debentures. Except for this effort to sell *P* debentures, the underwriter has no relationship with *P* or *P's* shareholders. The underwriter has considerable experience in dealing with debt financing in situations of this type. The underwriter has advised *P* that potential investors could decline to invest in *P* because *P*'s balance sheet would divulge its holding of *S*, and raise fears that the funds invested in *P* would be diverted to improve *S*'s financial position. The underwriter has stated that, even if sufficient interest could be stimulated among potential investors, the terms and conditions of the debentures would be significantly more burdensome to *P*, if *P* remains associated with *S*. Finally, the underwriter has stated that a holding company structure in which *P* and *S* would both be first tier subsidiaries of a new parent company would not solve *P*'s problem, as potential investors would take into account *S*'s performance in evaluating the group's financial statements.

The underwriter has engaged in informal preliminary discussions of *P*'s situation with persons who frequently purchase the underwriter's offerings. Even though the underwriter has attempted to explain that *P* (as *S*'s shareholder) is not liable to *S*'s creditors, the underwriter encountered reluctance to invest in *P* as long as *P* and *S* are associated. Based on prior experience with similar situations, and on the result of these informal preliminary discussions, the underwriter has recommended that all the *S* stock be distributed to the *P* shareholders. This would permit *P* to prepare financial statements without reflecting the results and conditions of *S*'s operation. The underwriter will then put together a syndicate of investors to purchase the *P* debentures. The amount of capital to be raised is considered adequate to meet the needs of *P*'s operations.

In accordance with the underwriter's recommendation that *P* divest itself of *S*, *P* will distribute the *S* stock pro rata to the *P* shareholders. Except for the question here at issue regarding business purposes, distribution of the *S* stock to the *P* shareholders will meet all the requirements of section 355 of the Internal Revenue Code and the regulations thereunder.

LAW AND ANALYSIS

Section 355 of the Code provides that under certain circumstances a corporation may distribute stock or securities in a corporation it controls to its shareholders or its security holders in a transaction that is nontaxable to such shareholders or security holders. Section 1.355-2(c) of the regulations states that a distribution by a corporation of stock or securities of a controlled corporation to its shareholders with respect to its own stock will not qualify under section 355 of the Code when carried out for purposes not germane to the business of the corporations. This rrequirement is intended to limit the application of section 355 to those readjustments of corporate structure that are requied by business exigencies.

The distribution by *P* of the *S* stock is for purposes germane to the business of *P* within the meaning of section 1.355-2(c) of the regulations, since it is the result of a recommendation by an independent and experienced underwriter who, from both prior experience and present contacts, has concluded that any relationship between *P* and *S* will have a significant adverse affect on investor perception of *P* debentures, and since it is reasonable to expect that the distribution of the *S* stock will be of significant help to *P* in securing needed additional capital.

HOLDING

The business purpose requirement of section 1.355-2(c) of the regulations is met when the *S* stock is distributed under the circumstances described.

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26 CFR. 1.355-2: Limitations.

Controlled corporation; stock distribution; business purpose. The business purpose requirement under section 355 of the Code is met if a corporation transfers one of its two active businesses to a new corporation for all of the stock and then splits off the subsidiary in order to retain the services of a key employee-shareholder of the split-off business.

Rev. Rul. 85-127

ISSUE

Is the business purpose requirement of section 1.355-2(c) of the Income Tax Regulations met by a distribution of stock of a controlled corporation, under the circumstances described below?

FACTS

X corporation has two divisions, *Division I* and *Division II*, each of which has been engaged in the active conduct of a trade or business for each of the past 5 years. *X* has outstanding 500 shares of common stock, which are held 400 shares by individual *A* and 100 shares by individual *B*.

The value of the *X* stock has increased substantially in recent years largely as a result of the efforts of *B*, a key employee and manager of *X*'s *Division II*. *B* is seriously considering terminating employment with *X*, if not offered the opportunity to acquire a controlling equity interest in the busi-

ness of *Division II*. However, *B* lacks the funds to purchase any additional equity.

In order to retain *B*'s services for *Division II*, *X* proposes to undertake the following two steps. *X* will transfer to *Y*, a newly formed corporation, the assets, subject to liabilities, associated with the business of *Division II* solely in exchange for 500 shares of *Y*'s common stock. Then, *X* will distribute 300 shares of this *Y* common stock to *B* in exchange for all of *B*'s 100 shares of *X* common stock, and *X* will distribute the remaining 200 shares of *Y* common stock to *A*, without *A* surrendering any *X* stock. The value of the *Y* stock received by *B* will be equal to the value of the *X* stock surrendered by *B*.

Except for the business purpose issue, the distribution of the *Y* stock to *A* and *B*, as described above, will meet all the requirements of sections 368(a)(1)(D) and 355 of the Internal Revenue Code and the regulations thereunder.

LAW AND ANALYSIS

Section 368(a)(1)(D) of the Code provides that a reorganization includes a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan , stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356.

Section 355 of the Code provides that under certain circumstances a corporation may distribute stock or securities in a corporation it controls to its shareholders or security holders in a transaction that is not taxable to those shareholders or security holders. Section 1.355-2(c) of the regulations states that a distribution by a corporation of stock or securities of a controlled corporation to its shareholders with respect to its own stock will not qualify under section 355 of the Code when carried out for purposes not germane to the business of the corporations. This provision is intended to limit the application of section 355 to those readjustments of corporate structure that are required by business exigencies.

The transfer of the *Division II* business to *Y* and the distribution by *X* of the *Y* stock will be carried out for purposes germane to the business of *X* within the meaning of section 1.355-2(c) of the regulations, since this transfer and distribution will enable the business to retain a key employee.

HOLDING

The distribution of the *Y* stock is supported by a valid business purpose within the meaning of section 1.355-2(c) of the regulations. Since all other requirements of section 355 of the Code and regulations thereunder have been met, the distribution qualifies under section 355. The transfer by *X* of part of its assets to *Y* in exchange for *Y* stock is a reorganization as defined in section 368(a)(1)(D) of the Code.

Section 358.—Basis to Distributees

26 CFR 1.358-2: Allocation of basis among nonrecognition property.

Whether a taxpayer may, in a section 351 exchange, allocate transferred low-basis property to stock received in exchange and allocate transferred high-basis property to securities received in exchange. See Rev. Rul. 85-164, page 117.

Subpart D.—Special Rules; Definitions

Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368-1: Purpose and scope of exception of reorganization exchanges.

Reorganizations; continuity of business enterprise. The merger of a holding company into its wholly owned operating subsidiary qualifies as a tax-free reorganization because the continuity of business enterprise requirement of section 1.368-1(d) of the regulations is satisfied.

Rev. Rul. 85-197

ISSUE

Whether the continuity of business enterprise requirement stated in section 1.368-1(d) of the Income Tax Regulations is satisfied under the facts described below.

FACTS

P is a holding company whose only asset consists of all the stock of an operating subsidiary, *S*. *P* merges into *S* and the *P* shareholders exchange their *P* stock for *S* stock.

LAW AND ANALYSIS

Section 1.368-1(b) of the regulations states that requisite to a reorganization under the Internal Revenue Code is a continuity of the business enterprise under modified corporate form.

Section 1.368-1(d)(3) of the regulations states that the continuity of business enterprise requirement is satisfied if the acquiring corporation continues the historic business of the acquired corporation. Section 1.68-1(d)(2) of the regulations states that:

The application of this general rule to certain transactions, such as mergers of holding companies, will depend on all facts and circumstances. The policy underlying this general rule, which is to ensure that reorganizations are limited to readjustments of continuing interests in property under modified corporate form, provides the guidance necessary to make these facts and circumstances determinations.

In the instant case, the policy enunciated in section 1.368-1(d)(2) of the regulations is satisfied. For purposes of the continuity of business enterprise requirement, the historic business of *P* is the business of *S*, its operating subsidiary. Therefore, after the merger, *S* continues to conduct *P*'s historic business.

HOLDING

The continuity of business enterprise requirement is satisfied when a holding company is merged into its wholly owned operating subsidiary.

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26 CR 1.368-1: Purpose and scope of exception of reorganization exchanges.

Reorganizations; bank holding company; continuity of business enterprise. The continuity of business enterprise requirement of section 1.368-1(d) of the regulations is satisfied and the merger of bank holding companies qualifies as a tax-free reorganization when the business of the former subsidiary of the merged bank holding company is carried on in the same manner and form indirectly, through a second tier subsidiary, of the surviving bank holding company.

Rev. Rul. 85-198

ISSUE

Whether the continuity of business enterprise requirement set forth in section 1.368-1(d) of the Income Tax Regulations is satisfied under the facts described below.

FACTS

P is a bank holding company with a number of wholly owned banking subsidiaries. *T* is a bank holding company with one banking subsidiary, *S1*. *T* owns all of the stock of *S1*. *S1* owns all of the stock of *S2*, a mortgage banking company. The value of the *S2* stock represents a substantial percentage of the value of *S1*. In order to acquire the existing mortgage banking business of *S2*, *P* will acquire *T*. Pursuant to a single overall plan, *T* will merge with and into *P*. *P* will then cause *S1* to distribute all of the stock of *S2* to *P*. *P* will transfer the *S2* stock to one of its wholly-owned banking subsidiaries and, for valid business reasons, *P* will sell *S1* to an unrelated purchaser.

LAW AND ANALYSIS

Section 1.368-1(b) of the regulations states that requisite to a reorganization under the Internal Revenue Code is a continuity of the business enterprise under modified corporate form.

Section 1.368-1(d)(2) of the regulations states that a continuity of business enterprise requires that the acquiring corporation either continue the historic business of the acquired corporation or use a significant portion of the acquired corporation's historic business assets in a business. The same section states that:

The application of this general rule to certain transactions, such as megers of holding companies, will depend on all facts and circumstances. The policy underlying this general rule, which is to ensure that reorganizations are limited to readjustments of continuing interests in property under modified corporate form, provides the guidance necessary to make these facts and circumstances determinations.

Also, section 1.368-1(d)(3)(ii) states that if the acquired corporation has more than one line of business, the acquiring corporation need only continue a significant line of business.

In the instant case, the policy enunciated in section 1.368-1(d)(2) of the Regulations is satisfied. *T* indirectly operates two significant businesses through its wholly owned subsidiaries, *S1* and *S2*. After the merger *P* will continue to operate, indirectly, one of the two significant businesses through *S2*, now *P*'s second tier subsidiary. *See* section 1.368-1(d)(5), Ex. 1 of the Regulations.

HOLDING

The continuity of business enterprise requirement is satisfied.

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26 CFR 1.368-1: Purpose and scope of exception of reorganization exchanges.

A statutory merger qualifying as a reorganization under section 368(a)(1)(A) of the Code does not terminate the surviving corporation's election to be treated as a possessions corporation pursuant to section 936. See Rev. Rul. 85-124, page 179.

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26 CFR 1.368-2: Definition of terms.

Reorganizations; "solely for voting stock" requirement. An acquiring corporation's pre-existing stock ownership interest in an acquired corporation will not prevent the application of section 368(a)(1)(D) of the Code to a transaction that otherwise qualifies under that section. Rev. Rul. 54-396 distinguished.

Rev. Rul. 85-107

ISSUES

Whether Rev. Rul. 54-396, 1954-2 C.B. 147, and the decision in *Bausch & Lomb Optical Co. v. Commissioner*, 30 T.C. 602 (1958), *aff'd*, 267 F.2d 75 (2d Cir.), *cert. denied*, 361 U.S. 835 (1959), are applicable to a transaction that otherwise qualifies as a reorganization under the provisions of section 368(a)(1)(D) of the Internal Revenue Code of 1954.

FACTS

P corporation owned 50 percent of the outstanding stock of *T* corporation and 80 percent of the outstanding stock of *S* corporation. The remaining 50 percent of the outstanding stock of *T* was owned by *S*. *P*, *S*, and *T* do not make a consolidated return. The *T* stock was acquired by *P* and *S* for cash more than 20 years ago.

Pursuant to a plan of reorganization and for valid business reasons, *T* transferred all its properties to *S* in exchange for *S* voting stock and the assumption by *S* of the liabilities of *T*. *S*'s 50 percent stock interest in *T* was cancelled. The *S* stock received by *T* was distributed to *P* in exchange for its *T* stock, and *T* was dissolved. Except for the question here at issue with respect to the application of Rev. Rul. 54-396 and the *Bausch & Lomb* doctrine, the transaction met all the requirements of section 368(a)(1)(D) of the Code.

LAW AND ANALYSIS

Section 368(a)(1)(C) of the Code provides that the term "reorganization" includes the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all of the properties of another corporation.

Section 368(a)(1)(D) of the Code provides that the term "reorganization" includes a transfer by a corporation of all its assets to another corporation if immediately after the transfer the transferor, or its shareholders, is in control of the corporation to which the assets are transferred, provided that the stock of the transferee corporation is distributed in a transaction which qualifies under section 354.

For purposes of nondivisive transactions under section 368(a)(1)(D) of the Code, section 368(c)(2), through reference to section 304(c), provides that the term "control" means ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote, or at least 50 percent of the total value of shares of all classes of stock of the corporation.

Under the provisions of section 354(b) of the Code, the general nonrecognition provisions of section 354(a) apply to a section 368(a)(1)(D) reorganization so long as the transferee corporation acquires substantially all the assets of the transferor and the stock received by such transferor (as well as any other property still held by the transferor) is distributed in pursuance of the plan of reorganization.

In Rev. Rul. 54-396, *M* corporation, owning 79 percent of the stock of *N* corporation, acquired all the assets of *N* in exchange for *M* voting stock. *N* was then liquidated and the *M* stock was

distributed to the *N* shareholders. Rev. Rul. 54-396 holds that the acquisition by *M* of all the assets of *N* in exchange for the *M* stock, followed by the liquidation of *N*, did not constitute a reorganization under section 112(g)(1)(C) of the Internal Revenue Code of 1939 (the predecessor to section 368(a)(1)(C) of the 1954 Code) since *M*, in substance, obtained only 21 percent of *N*'s assets in exchange for *M* stock, the balance being acquired as a liquidating distribution in exchange for *M*'s 79 percent stock interest in *N*. The transaction therefore did not satisfy the "solely for voting stock" requirement of section 112(g)(1)(C) of the 1939 Code.

The position taken in Rev. Rul. 54-396 was sustained under similar facts in *Bausch & Lomb Optical Co. v. Commissioner*, decided under the 1939 Code. In *Bausch & Lomb*, the acquiring corporation owned a majority (but less than 80 percent) of the stock of the acquired corporation. The acquired corporation transferred its assets to the acquiring corporation for voting stock of the acquiring corporation and then went out of existence. The "solely for voting stock" requirement of section 112(g)(1)(C) of the 1939 Code was held not to be satisfied because the effect of the transaction was the acquisition by the acquiring corporation of the assets of the acquired corporation in exchange for voting stock of the acquired corporation held by the acquiring corporation. The *Bausch & Lomb* opinion on appeal suggests that in a statutory merger in which the acquiring corporation owned stock of the acquired corporation, the pre-existing stock ownership would not prevent the transaction from qualifying as a reorganization described in section 112(g)(1)(A) of the 1939 Code (the predecessor of section 368(a)(1)(A) of the 1954 Code). *See also Grede Foundries, Inc. v. United States*, 202 F. Supp. 263 (E.D. Wis. 1962), decided under the 1954 Code. Similarly, in the present situation, since the definition contained in section 368(a)(1)(D) of the Code does not include a "solely for voting stock" requirement, the *Bausch & Lomb* rationale does not apply in determining whether the acquisition of the *T* assets by *S* meets the requirements of section 368(a)(1)(D).

HOLDING

Rev. Rul. 54-396 and the decision in *Bausch & Lomb Optical Co. v. Commissioner* do not apply to a reorganization which otherwise qualifies under the provisions of section 368(a)(1)(D) of the Code.

EFFECT ON
OTHER DOCUMENTS

Rev. Rul. 54-396 distinguished.

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26 CFR 1.368-2: Definition of terms.

Reorganizations; solely for voting stock; stock purchased in preconceived plan. The acquisition of substantially all of the properties of a corporation by a wholly owned subsidiary of a parent corporation is not considered to be in exchange solely for voting stock so as to qualify as a reorganization where stock of the acquired corporation was previously purchased for cash by another wholly owned subsidiary of that parent corporation pursuant to an overall plan of reorganization.

Rev. Rul. 85-138

ISSUE

Whether the acquisition of substantially all the properties of *X* by *S1* under the facts described below meets the requirements of a reorganization pursuant to section 368(a)(1)(C) of the Internal Revenue Code.

FACTS

Corporation *P* owned all the stock of corporation *S1* and corporation *S2*. It was *P*'s desire that *S1* acquire substantially all the properties of *X*, a corporation unrelated by stock ownership to *P*, *S1* or *S2*. In order to eliminate any possible adverse minority interest in *X*, and pursuant to a plan adopted by *P*, *P* caused *S2* to purchase with *S2*'s own cash some of the shares of outstanding voting stock of *X*. *S2*, along with the other shareholders of *X*, then approved an agreement between *P* and *X* under which *X* transferred substantially all its properties to *S1* in exchange for voting stock of *P* and the assumption by *S1* of all of *X*'s liabilities. The liabilities assumed by *S1* were in excess of twenty percent of the fair market value of *X*'s assets. Subsequent to this exchange, *X* was dissolved and the *P* stock was distributed to the shareholders of *X* (including *S2*) in exchange for the surrender and cancellation of all the *X* stock.

LAW AND ANALYSIS

Section 368(a)(1)(C) of the Code provides that the term "reorganization" means the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all the properties of another corporation, but in determining whether the exchange is solely for stock, the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded.

Section 368(a)(2)(B) of the Code provides that if (i) one corporation acquires substantially all of the properties of another corporation, (ii) the acquisition would qualify under section 368(a)(1)(C) but for the fact that the acquiring corporation exchanges money or other property in addition to voting stock, and (iii) the acquiring corporation acquires, solely for voting stock described in section 368(a)(1)(C), property of the other corporation having a fair market value which is at least 80 percent of the fair market value of all of the property of the other corporation, then such acquisition will (subject to section 368(a)(2)(A)) be treated as qualifying under section 368(a)(1)(C). Soley for the purpose of determining whether clause (iii) of the preceding sentence applies, the amount of any liability assumed by the acquiring corporation, and the amount of any liability to which any property acquired by the acquiring corporation is subject, will be treated as money paid for the property. Thus, if nonqualifying consideration such as cash is furnished by the acquiring corporation, liabilities of the acquired corporation assumed by the acquiring corporation are added to cash paid in order to determine whether 80 percent of the fair market value of the assets of the acquired corporation are exchanged solely for voting stock. In the instant case, *S1*'s assumption of *X* liabilities in excess of 20 percent of the fair market value of *X* assets effectively precludes the application of the boot relaxation rule of section 368(a)(2)(B) of the Code. As a result, if *S1* is deemed

to have exchanged partly *P* voting stock and partly cash for substantially all the assets of *X*, the transaction will not qualify as a reorganization under section 368(a)(1)(C) of the Code.

In Rev. Rul. 69-48, 1969-1 C.B. 106, corporation *P* purchased for cash nineteen percent of the stock of corporation *X* and acquired an option to purchase an additional thirty percent as part of a plan for *P*'s wholly-owned subsidiary, *S*, to acquire the assets of *X*.

Under the option agreement, *P* was able to vote the optioned stock as well as the stock it had purchased outright. Twenty-two months later, *P* voted for the transfer of *X*'s assets to *S* in exchange for *P* voting stock and the assumption by *S* of *X*'s liabilities. After the transfer of its assets, *X* was liquidated. Rev. Rul. 69-48 concludes that *P*'s cash purchase of *X* stock violated the "solely for voting stock" requirement of section 368(a)(1)(C) because it was an integral step in the plan to acquire substantially all of *X*'s assets.

In the present case, *S2*'s prearranged cash purchase of *X* shares was an integral step in the plan for *S1* to acquire substantially all the assets of *X*. Therefore, as in Rev. Rul. 69-48, the consideration for the acquisition of *X*'s properties by *S1* is deemed to consist of cash in addition to the voting stock of *P* and the assumption of liabilities by *S1* permitted under section 368(a)(1)(C) of the Code.

HOLDING

The transaction does not qualify as a reorganization defined in section 368(a)(1)(C) of the Code. Compare Rev. Rul. 85-139 wherein the same conclusion is reached in a purported reorganization under section 368(a)(1)(B).

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26 CFR 1.368-2: Definition of terms.

Reorganizations; solely for voting stock; cash purchases of stock. The "solely for voting stock" requirement of section 368(a)(1)(B) of the Code is not met if the acquiring corporation exchanges its voting stock for 90 percent of the acquired corporation's outstanding stock and the acquiring corporation causes its wholly owned subsidiary to purchase 10 percent of the acquired corporation's outstanding stock for cash.

Rev. Rul. 85-139

ISSUE

Whether the transaction described below qualifies as a reorganization under section 368(a)(1)(B) of the Internal Revenue Code.

FACTS

P corporation owned all the stock of *S* corporation. *P* desired to obtain control of *X* corporation by acquiring all the shares of the one outstanding class of stock of *X* solely in exchange for *P* voting stock. Certain shareholders of *X*, owning ten percent of its stock, insisted, however, on receiving cash for their stock. Since *P* wanted to eliminate any possible adverse minority interest in *X*, and pursuant to one overall plan to acquire the stock of *X*, *P* acquired ninety percent of the stock of *X* solely in exchange for *P* voting stock, and *P* caused *S* to purchase for cash the remaining ten percent of the *X* stock. The cash paid by *S* for *X*'s stock was not obtained directly or indirectly from *P*. *S* retained ownership of the *X* stock it had purchased.

LAW AND ANALYSIS

Section 368(a)(1)(B) of the Code provides that the term "reorganization" means the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or part of the voting stock of a corporation which is in control of the acquiring corporation), of stock of another corporation, if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition).

Section 1.368-2(c) of the Income Tax Regulations illustrates the application of the "solely for voting stock" requirement under section 368(a)(1)(B) as follows:

If, for example, corporation X in one transaction exchanges nonvoting preferred stock or bonds in addition to all or a part of its voting stock in the acquisition of stock of corporation Y, the transaction is not a reorganization under section 368(a)(1)(B).

The "solely for voting stock" requirement applies to the entire transaction in which stock of a corporation is acquired, not just to the acquisition of a block of stock constituting control. Therefore, the acquisition by a corporation of eighty percent of the stock of a corporation in exchange for its voting stock and the remaining twenty percent in exchange for cash violates "solely for voting stock." Rev. Rul. 75-123, 1975-1 C.B. 115; *Chapman v. Commissioner*, 618 F.2d 856 (1st Cir. 1980), *cert. dism.* 451 U.S. 1012 (1981); *Heverly v. Commissioner*, 621 F.2d 1227 (3d Cir. 1980, *cert. dism.* 451 U.S. 1012 (1981); *Commissioner v. Turnbow*, 286 F.2d 669 (9th Cir. 1960), *aff'd on other issues*, 368 U.S. 337 (1961).

Accordingly, if *P* had acquired all the stock of *X* in exchange for its voting stock and cash, the acquistion would not have qualified as a reorganization under section 368(a)(1)(B). *P*'s structuring of the transaction to have its wholly owned subsidiary acquire some of the *X* stock for cash does not produce a different result. Compare Rev. Rul. 69-48, 1969-1 C.B. 106, which holds that the purchase for cash by *P* of stock of corporation *X* as part of a plan for *P*'s wholly-owned subsidiary, *S*, to acquire substantially all the assets of *X* for *P* voting stock, violates the "solely for voting stock" requirement of section 368(a)(1)(C).

HOLDING

The purchase by *S* of ten percent of *X*'s stock for cash violates the "solely for voting stock" requirement of section 368(a)(1)(B) of the Code. Compare Rev. Rul. 85-138, wherein it was held that a similar transaction does not qualify as a reorganization under section 368(a)(1)(C).

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26 CFR 1.368-2: Definition of terms.

T.D. 8059

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Statutory Merger Using Voting Stock of the Corporation Controlling the Merged Corporation

AGENCY: Internal Revenue Service,

Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the statutory merger of a controlled corporation into an acquiring corporation using the voting stock of the corporation controlling the merged corporation (reverse triangular merger). Changes to the applicable tax law were made by Public Law 91-693 [1971-1 C.B. 553]. These regulations affect corporations involved in reverse triangular mergers, and the shareholders and security holders of those corporations, and provide guidance needed to comply with the law.

DATES: These regulations are effective upon publication in the FEDERAL REGISTER. These regulations apply to statutory mergers occurring after December 31, 1970.

FOR FURTHER INFORMATION CONTACT: Andrew B. Pullman of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (202-566-3458, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On January 2, 1981, the FEDERAL REGISTER published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 368 of the Internal Revenue Code of 1954 (the "Code") (46 FR 114) [LR-1994, 1981-1 C.B. 706]. The amendments were proposed to conform the regulations to Public Law 91-693, which added section 368(a)(2)(E) to the Code. Because a public hearing was not requested, no public hearing was held. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

SUMMARY OF PUBLIC COMMENTS AND CHANGES TO PROPOSED REGULATIONS

Control requirement

Section 368(a)(2)(E)(ii) of the Code requires that, in the transaction, former shareholders of the surviving corporation (hereinafter "T") exchange, for voting stock of the controlling corporation (hereinafter "P"), an amount of stock which constitutes control of T (as defined in section 368(c) of the Code). Section 1.368-2(j)(3)(i) of the proposed regulations provides that the amount of T stock surrendered in the transaction by T shareholders in exchange for P voting stock must itself constitute control. Accordingly, if P owns more than 20 percent of T, the transaction does not qualify under section 368(a)(2)(E). Example (3) of proposed §1.368-2(j)(7) illustrates that result. Numerous commenters suggested that, instead, the regulations provide that the requirement of section 368(a)(2)(E)(ii) is satisfied if, in the transaction, T shareholders surrender in exchange for P voting stock an amount of T stock which, when added to P's prior stock ownership in T, constitutes control.

After careful consideration, it is concluded that the statute does not permit the interpretation advanced by the commenters. Section 1.368-2(j)(3)(i) and example (4) of §1.368-2(j)(7) of the final regulations retain the rule set forth in the proposed regulations. Examples (6) and (7) of §1.368-2(j)(7) of the final regulations clarify, however, that the control requirement of section 368(a)(2)(E)(ii) may be satisfied despite the fact that, in the transaction, P contributes money or other property to T in exchange for additional T stock, or P receives T stock in exchange for its prior interest in the merged corporation (hereinafter "S"). However, as illustrated in example (9) of §1.368-2(j)(7) of the final regulations, the receipt of such T stock will not contribute to satisfaction of that control requirement.

Section 1.368-2(j)(3)(i) of the proposed regulations also provides that, for purposes of the control requirement, T's outstanding stock is measured immediately before the transaction. Further, as illustrated in examples (2) and (4) of proposed §1.368-2(j)(7), payments to T's shareholders other than P voting stock (such as cash payments to dissenters or payments in redemption of T stock), as part of the transaction, could prevent satisfaction of that requirement. Several commenters suggested that, similar to reorganizations under section 368(a)(1)(B), payments to T's shareholders could be disregarded for purposes of the control requirement, provided the consideration was furnished by T and not by P. In response, §1.368-2(j)(3)(i) of the final regulations, reflecting an interpretation of the statute which looks to the consideration furnished by P rather than that received by the T shareholders, provides that such payments by T and not by P may be disregarded for purposes of section 368(a)(2)(E)(ii). As with reorganizations under section 368(a)(1)(B), the facts and circumstances of each case will determine whether the payments came from T or P. Examples (2) and (3) of §1.368-2(j)(7) of the final regulations illustrate that result. However, §1.368-2(j)(3)(i) and (iii) also clarify that those payments are treated as a reduction of T's properties for purposes of section 368(a)(2)(E)(i), which requires that, after the transaction, T hold substantially all of its properties. In addition, receipt of consideration other than P stock by T shareholders in the transaction could prevent satisfaction of the continuity of interest requirement.

Section 1.368-2(j)(3)(i) of the proposed regulations defines control under section 368(c). Since current law is sufficiently clear as to the definition of control under section 368(c), the final regulations do not contain such a definition.

Section 1.368-2(j)(3)(ii) of the proposed regulations provides that P must acquire control of T in the transaction. Section 1.368-2(j)(3)(ii) of the final regulations clarifies this rule to provide that P must be in control of T immediately after the transaction. Thus, any disposition by P of the T stock acquired (other than a transfer described in section 368(a)(2)(C)), or any new issuance of stock by T to persons other than P, as part of the transaction, which causes P not to be in control of T will prevent the transaction from qualifying under section 368(a)(2)(E). Example (8) of §1.368-22(j)(7) of the final regulations illustrates this rule.

"Substantialy all" requirement

Section 368(a)(2)(E)(i) of the code requires generally that, after the transaction, T hold substantially all of its properties and substantially all of the properties of S. Section 1.368-2(j)(4) of the proposed regulations indicates that this requirement will not be

satisfied where, as part of the transaction, T transfers assets to a corporation controlled by T, notwithstanding section 368(a)(2)(C) of the Code. Several commenters suggested that section 368(a)(2)(C) permits assets of T to be transferred to a controlled corporation without violating the "substantially all" requirement. In response, §1.368-2(j)(4) of the final regulations provides that such transfers do not violate the "substantially all" requirement.

Section 1.368-22(j)(3)(iii)(E) of the final regulations clarifies that money transferred from P to S to satisfy minimum state capitalization requirements, which eventually is returned to P as part of the transaction, is not taken into account in applying the "substantially all" test to the assets of S.

Assumption of liabilities; exchange of securities

Section 1.368-2(j)(5) of the proposed regulations provides that P may assume liabilities of T without disqualifying the transaction under section 368(a)(2)(E). Commenters requested that the regulations clarify the treatment of such liability assumption by P. Accordingly, §1.368-2(j)(5) of the final regulations clarifies that liability assumption is a contribution to the capital of T by its shareholder P. In addition, §1.368-2(j)(5) of the final regulations clarifies that where, pursuant to the plan of reorganization, securities of T are exchanged for securities of P, or for other securities of T which, for example, are convertible into P stock, that exchange is subject to the otherwise applicable provisions of section 354 and 356.

Relation to section 368(a)(1)(B)

A few commenters suggested that the regulations confirm that a transaction which fails to qualify under section 368(a)(2)(E) may, under appropriate circumstances, qualify as a reorganization described in section 368(a)(1)(B), as in Rev. Rul. 67-448, 1967-2 C.B. 144. Examples (4) and (5) of §11.368-2(j)(7) of the final regulations confirm this result.

Merged corporation

Finally, in response to comments, §1.368-2(j)(6) of the final regulations clarifies that S can be an existing corporation as well as a corporation formed for purposes of the section 368(a)(2)(E) transaction.

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Because the notice of proposed rulemaking for these regulations was filed with the Federal Register on December 29, 1980, no regulatory flexibility analysis is required.

DRAFTING INFORMATION

The principal author of these regulations is Andrew B. Pullman of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations, both on matters of substance and style.

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Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph 1. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805.***

Par. 2. Section 1.368-2 is amended by adding paragraphs (b)(3), (i), and (j). These added provisions read as follows:

§1.368-2 Definition of terms.

* * * * *

(b) * * *

(3) For regulations under section 368(a)(2)(E), see paragraph (j) of this section.

* * * * *

(i) [Reserved]

(j)(1) This paragraph (j) prescribes rules relating to the application of section 368 (a)(2)(E). Section 368(a)(2)(E) applies to statutory mergers occurring after December 31, 1970.

(2) Section 368(a)(2)(E) does not apply to a consolidation.

(3) A transaction otherwise qualifying under section 368(a)(1)(A) is not disqualified by reason of the fact that stock of a corporation (the controlling corporation) which before the merger was in control of the merged corporation is used in the transaction, if the conditions of section 368(a)(2)(E) are satisfied. Those conditions are as follows:

(i) In the transaction, shareholders of the surviving corporation must surrender stock in exchange for voting stock of the controlling corporation. Further, the stock so surrendered must constitute control of the surviving corporation. Control is defined in section 368(c). The amount of stock constituting control is measured immediately before the transaction. For purposes of this subdivision (i), stock in the surviving corporation which is surrendered in the transaction (by any shareholder except the controlling corporation) in exchange for consideration furnished by the surviving corporation (and not by the controlling corporation or the merged corporation) is considered not to be outstanding immediately before the transaction. For effect on "substantially all" test of consideration furnished by the surviving corporation, see paragraph (j)(3)(iii) of this section.

(ii) Except as provided in paragraph (j)(4) of this section, the controlling corporation must control the surviving corporation immediately after the transaction.

(iii) After the transaction, except as provided in paragraph (j)(4) of this section, the surviving corporation must hold substantially all of its own properties and substantially all of the properties of the merged corporation (other than stock of the controlling corporation distributed in the transaction). The term "substantially all" has the same meaning as in section 368(a)(1)(C). The "substantially all" test applies separately to the merged corporation and to the surviving corporation. In applying the "substantially all" test to the surviving corporation, consideration furnished in the transaction by the surviving corporation in exchange for its stock is property of the surviving corporation which it does not hold after the transaction. In applying the "substantially all" test to the merged corporation, assets transferred from the controlling corporation to the merged corporation in pursuance of the plan of reorganization are not taken into account. Thus, for example, money

transferred from the controlling corporation to the merged corporation to be used for the following purposes is not taken into account for purposes of the "substantially all" test:

(A) To pay additional consideration to shareholders of the surviving corporation;

(B) To pay dissenting shareholders of the surviving corporation;

(C) To pay creditors of the surviving corporation;

(D) To pay reorganization expenses; or

(E) To enable the merged corporation to satisfy state minimum capitalization requirements (where the money is returned to the controlling corporation as part of the transaction).

(4) A transaction qualifying under section 368(a)(1)(A) by reason of the application of section 368(a)(2)(E) is not disqualified merely because part or all of the stock of the surviving corporation is transferred to a corporation controlled by the controlling corporation, or because part or all of the assets of the surviving corporation or the merged corporation are transferred to a corporation controlled by the controlling corporation. See section 368(a)(2)(C).

(5) The controlling corporation may assume liabilities of the surviving corporation without disqualifying the transaction under section 368(a)(2)(E). An assumption of liabilities of the surviving corporation by the controlling corporation is a contribution to capital by the controlling corporation to the surviving corporation. If, in pursuance of the plan of reorganization, securities of the surviving corporation are exchanged for securities of the controlling corporation, or for other securities of the surviving corporation, see sections 354 and 356.

(6) In applying section 368(a)(2)(E), it makes no difference if the merged corporation is an existing corporation, or is formed immediately before the merger, in anticipation of the merger, or after preliminary steps have been taken to otherwise acquire control of the surviving corporation.

(7) The following examples illustrate the application of this paragraph (j). In each of the examples, Corporation P owns all of the stock of Corporation S and, except as otherwise stated, Corporation T has outstanding 1,000 shares of common stock and no shares of any other class. In each of the examples, it is also assumed that the transaction qualifies under section 368(a)(1)(A) if the conditions of section 368(a)(2)(E) are satisfied.

Example (1). P owns no T stock. On January 1, 1981, S merges into T. In the merger, T's shareholders surrender 950 shares of common stock in exchange for P voting stock. The holders of the other 50 shares (who dissent from the merger are paid in cash with funds supplied by P. After the transaction, T holds all of its own assets and all of S's assets. Based on these facts, the transaction qualifies under section 368(a)(1)(A) by reason of the application of section 368(a)(2)(E). In the transaction, former shareholders of T surrender, in exchange for P voting stock, an amount of T stock (950/1,000 shares or 95 percent) which constitutes control of T.

Example (2). The facts are the same as in example (1) except that holders of 100 shares in corporation T, who dissented from the merger, are paid in cash with funds supplied by T (and not by P or S) and in the merger, T's remaining shareholders surrender 720 shares of common stock in exchane for P voting stock and 180 shares of common stock for cash supplied by P. The requirements of section 368(a)(2)(E)(ii) are satisfied since, in the transaction, former shareholders of T surrender, in exchange for P voting stock, an amount of T stock (720/900 shares or 80 percent) which constitutes control of T. The T stock surrendered in exchange for consideration furnished by T is not considered outstanding for purposes of determining whether the amount of T stock surrendered by T shareholders for P stock constitutes control of T.

Example (3). T has outstanding 1,000 shares of common stock, 100 shares of nonvoting preferred stock, and no shares of any other class. On January 1, 1981, S merges into T. Prior to the merger, as part of the transaction, T distributes its own cash in redemption of the 100 shares of preferred stock. In the transaction, T's remaining shareholders surrender their 1,000 shares of common stock in exchange for P voting stock. The requirements of section 368(a)(2)(E)(ii) are satisfied since, in the transaction, former shareholders of T surrender, in exchange for P voting stock, an amount of T stock (1,000/1,000 shares or 100 percent) which constitutes control of T. The preferred stock surrendered in exchange for consideration furnished by T is not considered outstanding for purposes of determining whether the amount of T stock surrendered by T shareholders for P stock constitutes control of T. However, the consideration furnished by T for its stock is property of T which T does not hold after the transaction for purposes of the substantially all test in paragraph (j)(3)(iii) of this section.

Example (4). On January 1, 1971, P purchased 201 shares of T's stock. On January 1, 1981, S merges into T. In the merger, T's shareholders (other than P) surrender 799 shares of T stock in exchange for P voting stock. Based on these facts, in the transaction, former shareholders of T do not surrender, in exchange for P voting stock, an amount of T stock which constitutes control of T (799/1,000 shares being less than 80 percent). Therefore, the transaction does not qualify under section 368(a)(1)(A). However, if S is a transitory corporation, formed solely for purposes of effectuating the transaction, the transaction may qualify as a reorganization described in section 368(a)(1)(B) provided all of the applicable requirements are satisfied.

Example (5). On January 1, 1971, P purchased 200 shares of T's stock. On January 1, 1981, S merges into T. Prior to the merger, as part of the transaction, T distributes its own cash in redemption of 1 share of T stock from a T shareholder other than P. In the merger, T's remaining shareholders (other than P) surrender 799 shares of T stock in exchange for P voting stock. Based on these facts, in the transaction, former shareholders of T do not surrender, in exchange for P voting stock, an amount of T stock which constitutes control of T (799/999 shares being less than 80 percent). Therefore, the transaction does not qualify under section 368(a)(1)(A). However, if S is a transitory corporation, formed for purposes of effectuating the transaction, the transaction may qualify as a reorganization described in section 368(a)(1)(B) provided all of the applicable requirements are satisfied.

Example (6). The stock of S has a value of $25,000. The stock of T has a value of $75,000. On January 1, 1984, S merges into T. In the merger, T's shareholders surrender all of their T stock in exchange for P voting stock. After the transaction, T holds all of its own assets and all of S's assets. Based on these facts, the transaction qualifies under section 368(a)(1)(A) by reason of the application of section 368(a)(2)(E). In the transaction, former shareholders of T surrender, in exchange for P voting stock, an amount of T stock (1,000/1,000 shares or 100 percent) which constitutes control of T. The stock of T received by P in exchange for P's prior interest in S is not taken into account for purposes of section 368(a)(2)(E)(ii) since the amount of T stock constituting control of T is measured before the transaction.

Example (7). The stock of T has a value of $75,000. On January 1, 1984, S merges into T. In the merger, T's shareholders surrender all of their T stock in exchange for P voting stock. As part of the transaction, P contributes $25,000 to T in exchange for new shares of T stock. None of the cash received by T is distributed or otherwise paid out to former T shareholders. After the transaction, T holds all of its own assets and all of S's assets. Based on these facts, the transaction qualifies under section 368(a)(1)(A) by reason of the application of section 368(a)(2)(E). In the transaction, former shareholders of T surrender, in exchange for P voting stock, an amount of T stock (1,000/1,000 shares or 100 percent) which constitutes control of T. The T stock received by P in exchange for its contribution to T is not taken into account for purposes of section 368(a)(2)(E)(ii) since the amount of T stock constituting control of T is measured before the transaction.

Example (8). The facts are the same as in example (7) except that, as part of the transaction, corporation R, instead of P, contributes $25,000 to T in exchange for T stock. Based on these facts, the transaction does not qualify under section 368(a)(1)(A) by reason of section 368(a)(2)(E) since P does not control T immediately after the transaction.

Example (9). T stock has a value of $75,000. P owns 500 shares (1/2) of that stock with a value of $37,500. The stock of S has a value of $125,000. On January 1, 1984, S merges into T. In the merger, T's shareholders (other than P) surrender their T stock in exchange for P voting stock. Based on these facts, in the transaction, former shareholders of T do not surrender, in exchange for P voting stock, an amount of T stock which constitutes control of T (500/1,000 shares being less than 80 percent). Therefore, the transaction does not qualify under section 368(a)(1)(A). The stock of T received by P in exchange for P's prior interest in S does not contribute to satisfaction of the requirement of section 368(a)(2)(E)(ii).

ROSCOE L. EGGER JR.,
Commissioner of Internal Revenue.

Approved September 24, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on October 21, 1985, 8:45 a.m., and published in the issue of the Federal Register for October 22, 1985, 50 F.R. 42688)

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26 CFR 1.368-2: Definition of terms

The Service will resume issuing advance rulings or determination letters on the issue of whether the conversion of a financial institution from mutual to stock will qualify under section 368(a)(3)(D) of the Code without regard to whether the stock of the converted financial institution is acquired by a financial institution to which section 585 or section 593 of the Code applies. See Rev. Proc. 85-34, page 433.

Part V.—Carryovers

Section 381.—Carryovers in Certain Corporation Acquisitions

26 CFR 1.381(a)-1: General rule relating to carryovers in certain corporate acquisitions.

The election by the surviving corporation in a statutory merger that qualifies as a reorganization under section 368(a)(1)(A) of the Code to be treated as a possessions corporation pursuant to section 936 does not terminate. See Rev. Rul. 85-124, page 179.

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26 CFR 1.381(c)(4)-1: Method of accounting.

An adjustment under section 481(a) of the Code is required when there is an integration under section 381(c)(4) of the bad debt reserve of a thrift institution, computed under section 593, into a reserve of an acquiring commercial bank, computed under section 585, because such action results in a change in method of accounting. See Rev. Rul. 85-171, page 148.

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26 CFR 1.381(c)(26)-1: Credit for employment of certain new employees.

Carryovers and carrybacks of unused targeted jobs credit. See T.D. 8062, page 19.

Subchapter D.—Deferred Compensation, etc.
Part I.—Pension, Profit-Sharing, Stock Bonus Plans, etc.
Subpart A.—General Rule

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401-1: Qualified pension, profit-sharing, and stock bonus plans.

Procedure for determining whether an employer that establishes or maintains a qualified plan under this section is subject to the requirements of section 414(m) or 414(n) of the Code. See Rev. Proc. 85-43, page 501.

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26 CFR 1.401-1: Qualified pension, profit-sharing and stock bonus plans.

Whether a defined benefit plan maintained by more than one employer provides definitely determinable benefits, with the meaning of section 1.401-1(b)(1)(i) of the Income Tax Regulations, if it provides benefits only for those years for which the participant's employer makes contributions. See Rev. Rul. 85-130, page 137.

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26 CFR 1.401(a)-11T: Requirement of qualified joint and survivor annuity and qualified preretirement survivor annuity (Temporary). (Also Section 402; 1.402(f)-1T.)

T.D. 8037

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX—TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Notice, Election, and Consent Rules Under the Retirement Equity Act of 1984

AGENCY: Internal Revenue Service, Treasury

ACTION: Temporary regulations.

SUMMARY: This document provides temporary regulations relating to the notice, election and consent rules enacted by the Retirement Equity Act of 1984 [Pub. L. 98-397, 1984-2 C.B. 433]. The regulations will generally affect sponsors of, and participants in, pension, profit-sharing, and stock bonus plans, and they provide plan sponsors with guidance necessary to comply with the law.

In addition, the text of the temporary regulations set forth in this document also serves as the text of the notice of proposed rulemaking that appears * * * [on page 762, this Bulletin].

DATES: The regulations are effective June 19, 1985, and generally apply for plan years beginning after December 31, 1984, except as otherwise specified in the Retirement Equity Act of 1984.

FOR FURTHER INFORMATION CONTACT: Charles M. Watkins of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention CC:LR:T) (202-566-3903, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains temporary regulations relating to the requirements for payment of survivor annuities and other rules relating to qualified employee plans, as enacted by Titles II and III of the Retirement Equity Act of 1984 ("REA '84") (P.L. 98-397, 98 Stat. 1436 et seq.).

Taxpayers may rely on these temporary regulations for guidance pending the issuance of final regulations. These temporary regulations do not, however, address comprehensively the issues raised by Titles II and III of REA '84, and no inferences should be drawn by reason of the fact that an issue is not addressed in this Treasury decision.

Under section 101 of Reorganization Plan No. 4 of 1978, (43 FR 47713), the Secretary of the Treasury has jurisdiction over the subject matter addressed in these regulations (except the definition of a qualified domestic relations order). Therefore, under section 104 of the Reorganization Plan, these regulations apply when the Secretary of Labor exercises authority under Title I of the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1] (as amended, including the amendments made by Title I of REA '84).

PLAN AMENDMENTS

Plan amendments required by the Retirement Equity Act of 1984 must, in general, be adopted not later than the end of the first plan year to which the statutory provisions apply.

NONAPPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this Regulation is not subject to review under Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required.

REGULATORY FLEXIBILITY ACT

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for temporary regulations. Accordingly, this regulation does not constitute a regulation subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

PAPERWORK REDUCTION ACT

The collections of information contained in these regulations have been submitted to the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB under Control No. 1545-0928.

DRAFTING INFORMATION

The principal authors of these temporary regulations are William D. Gibbs and Charles M. Watkins, of the Employee Plans and Exempt Organizations Division of the Office of the Chief Counsel, Internal Revenue Service. Personnel from other offices of the Internal Revenue Service and Treasury Department also participated in developing the regulations, on matters of both substance and style.

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Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph 1. The authority citation for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805.

Paragraph 1a. Section 1.401(a)-11T is amended by adding the following Q & A's at the end thereof:

§1.401(a)-11T Requirement of qualified joint and survivor annuity and qualified preretirement survivor annuity (Temporary).

* * * * *

Q-23: If a participant's spouse consents to the participant's waiver of a survivor annuity form of benefit under section 417(a)(2)(A), is a subsequent spouse of the same participant bound by that consent?

A-23: No. A consent under section 417(a)(2)(A) by one spouse is binding only with respect to the consenting spouse.

Q-24: Does the spousal consent requirement of section 417(a)(2)(A) require that a spouse's consent be irrevocable?

A-24: No. A plan may preclude a spouse from revoking consent once it has been given. However, a plan may also permit a spouse to revoke a consent after it has been given, and thereby to render ineffective the participant's prior election not to receive a QPSA or QJSA.

Q-25: Does the spousal consent requirement of section 417(a)(2) apply with respect to a participant's affirmative election of a non-spouse beneficiary?

A-25: Yes. The spousal consent requirement of section 417(a)(2) applies to the participant's election of a nonspouse beneficiary. Thus, for example, if spouse B consents to participant A's election not to receive a QPSA, but instead to have any benefits payable upon A's death before the annuity starting date paid to A's children, A may not subsequently change beneficiaries without the consent of B. In addition, any consent must acknowledge the specific nonspouse beneficiary, including any class of beneficiaries or any contingent beneficiaries.

Q-26: Must the notice and rights required by section 417(a)(1) and (3) be provided to nonvested participants?

A-26: Yes.

Q-27: Are there special rules for certain participants who separated from service prior to August 23, 1984?

A-27: Yes. Section 303(e) of REA '84 provides special rules for certain participants who separated from service before August 23, 1984. Section 303(e)(1), which applies only to plans subject to section 401(a)(11) of the Code (as in effect on August 22, 1984), provides that participants whose annuity starting date did not occur before August 24, 1984, and who had one hour of service on or after September 2, 1974, but not after December 31, 1975, may elect to receive the benefits required to be provided under section 401(a)(11) of the Code (as in effect on August 22, 1984). Section 303(e)(2) provides that certain participants who had one hour of service on or after January 1, 1976, but not after August 22, 1984, may elect to be provided a QPSA under new sections 401(a)(11) and 417 in plans subject to these provisions. Section 303(e)(4)(A) requires plans to notify those participants of the provisions of section 303(e).

Q-28: When must a plan provide the notice required by section 303(e)(4)(A) of REA '84?

A-28: The notice required by section 303(e)(4)(A) must be provided no later than the earlier of:

(a) The date the first summary annual report provided after September 17, 1985 is distributed to participants; or

(b) September 30, 1985.

A plan will not fail to satisfy the preceding sentence if the plan provides the notice before January 1, 1987, and provides a fully subsidized qualified preretirement survivor annuity with respect to any participant described in section 303(e) who dies on or after July 19, 1985 and before the notice is received. For this purpose, an annuity payable to a nonspouse beneficiary elected by the participant, in lieu of a spouse, shall satisfy such survivor benefit. The notice required by this paragraph must be in writing and sent to the participant's last known address.

Q-29: Is there another time when plans must provide notice of the right, described in §303(e)(1) of REA '84, to elect a pre-REA '84 qualified joint and survivor annuity?

A-29: Yes. Notice of this right must also be provided to a participant at the time the participant applies for benefit payments.

Q-30: when must a plan provide the written explanation, required by section 417(a)(3)(B), of the QPSA to an individual who becomes a participant after age 32; or who was a participant on August 23, 1984, and, as of that date, had attained age 34?

A-30: (a) In the case of an individual who becomes a participant after age 32, the plan will satisfy the time requirement of section 417(a)(3)(B) if it provides the explanation by the end of the three-year period beginning with the first day of the first plan year for which the individual is a participant.

(b) In the case of an individual who

was a participant in the plan on August 23, 1984, and, as of that date, had attained age 34, the plan will satisfy the requirement of section 417(a)(3)(B) if it provides the explanation not later than December 31, 1985.

Q-31: When must a plan provide the written explanation, required by section 417(a)(3)(B), of the QPSA to a participant who separates from service before attaining age 32?

A-31: In the case of separation before age 32, a plan must provide the explanation at the time of separation or within one year after separation.

Q-32: what are the consequences of fully subsidizing the cost of either a qualified joint and survivor annuity (QJSA) or a qualified preretirement survivor annuity (QPSA), in accordance with section 417(a)(4)?

A-32: If a plan fully subsidizes a QJSA or QPSA (in accordance with section 417(a)(4)), it is not required to provide the written explanation required by section 417(a)(3)(A) or 417(a)(3)(B), respectively. Such a plan need not offer an election. However, if the plan offers an election, it must satisfy the election, consent, and notice requirements of section 417(a)(1), (2), and (3), even if it subsidizes the cost of the QJSA and QPSA in accordance with section 417(a)(4).

Q-33: What is a fully subsidized benefit?

A-33: A fully subsidized benefit is one under which no increase in cost, or decrease in benefits, to the participant may result from the participant's failure to elect another benefit. Thus, for example, if a plan provides a joint and survivor annuity and a lump sum option, the plan does not fully subsidize the joint and survivor annuity, even if the actuarial value of the joint and survivor annuity is greater than the amount of the lump sum payment, because the participant's benefit in the event of his early death would be less than the benefit that would have been received if the lump sum were elected.

Similarly, if a plan provides for a life annuity of $100 per month and a joint and 100% survivor benefit of $99 per month, the plan is not fully subsidizing the joint and survivor benefit. A QPSA would be fully subsidized if the participant's account is not reduced because of the QPSA coverage and if no charge to the participant is made for the coverage. Thus, the QPSA would be fully subsidized in a defined contribution plan because account balances are not reduced by the QPSA coverage and no charge is made against accounts for such coverage.

Par. 2. A new §1.402(f)-1T is added after §1.402(e)-1 to read as follows:

§1.402(f)-1T. Required explanation of rollovers, capital gains, and ten-year averaging tax treatment (Temporary).

(a) *General rules.* Section 402(f) requires plan administrators to give recipients of certain distributions a written explanation of the rules relating to the taxation of certain amounts as capital gains under section 402(a)(2), the separate tax on the ordinary income portion of lump-sum distributions under section 402(e), and the exclusion from gross income under section 402(a)(5) for amounts rolled over into eligible retirement plans. This notice must be provided to the recipient of any qualified total distribution or any partial distribution satisfying section 402(a)(5)(D)(i) that is made after December 31, 1985, not later than two weeks after the distribution is made.

(b) *Safe harbor notice.* The requirements of section 402(f)(1) may be satisfied by providing each recipient of a qualified total distribution or a partial distribution that satisfies the requirements of section 402(a)(5)(D)(i) a copy of the notice included in this paragraph. Additional information may be provided to distributees, except that such information may not be inconsistent with the following safe harbor notice:

SPECIAL TAX RULES

The Internal Revenue Code provides several complex rules relating to the taxation of the amounts you received in this distribution. This notice merely summarizes these rules. You should promptly consult a tax advisor in deciding what course to follow with respect to this distribution.

ROLLOVERS

The Internal Revenue Code permits you to avoid current taxation on any portion of the taxable amount of an eligible distribution by rolling over that portion into another qualified employer retirement plan that accepts rollover contributions or into an individual retirement arrangement (IRA). A tax-free rollover is accomplished by transferring the amount you are rolling over to the new plan or IRA *not later than 60 days* after you receive the amount from this plan and notifying the trustee or issuer of the new plan or IRA that you are making a rollover contribution. If you receive a series of distributions within a single year that would be treated as a lump sum distribution, the 60-day period does not expire until 60 days after the day you receive the last distribution in the series.

Not all plan distributions are eligible to be rolled over. A distribution must be either a "qualified total distribution" or a "partial distribution" in order to be rolled over. In general, a qualified total distribution is either a lump sum distribution or a distribution because of a plan termination. A lump sum distribution is the payment of all remaining benefits under a plan because of death or other separation from service or after the employee reach age 59 1/2. A partial distribution is payment of 50 percent or more of plan benefits that is not one of a series of periodic payments. A rollover of any portion of a partial distribution may disqualify a subsequent distribution from the same type of plan for capital gains treatment and 10-year averaging (described below). There are specific and technical qualifications and requirements set forth in section 402 of the Internal Revenue Code that must be satisfied in order for your plan distribution to be eligible to be rolled over.

CAPITAL GAINS TREATMENT AND 10-YEAR AVERAGING

If your distribution qualifies under section 402(e) of the Internal Revenue Code as a lump sum distribution, and no part of your distribution is rolled over, you may be able to elect to have the part of the distribution attributable to your participation in the plan before 1974 (if any) taxed as a long term capital gain, and the remainder taxed as ordinary income or under special 10-year averaging rules that may reduce the amount of income tax you will be required to pay on account of this distribution. Alternatively, you may elect to have the entire amount of the distribution taxed as ordinary income or under the 10-year averaging rules. In addi-

tion, 10-year averaging may not be elected unless the employee participated in the plan making the distribution for any part of at least five years.

Par. 2a. The authority citation for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 3. Section 602.101(c) is amended by inserting in the appropriate places in the table, "§1.401(a)-11T . . . 1545-0928" and "§1.402(f)-1T. . . . 1545-0928".

There is need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impractical to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 USC 7805).

JAMES I. OWENS,
Acting Commissioner of Internal Revenue.

Approved July 3, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 18, 1985, 8:45 a.m., and published in the issue of the Federal Register for July 19, 1985, 50 F.R. 29376)

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26 CFR 1.401(a)-11T: Requirement of qualified joint and survivor annuity and qualified preretirement survivor annuity (Temporary). (Also Sections 410, 411, 417; 1.410(a)-5T, 1.411(a)(11)-1T, 1.417(e)-1T.)

T.D. 8038

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX—TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Effective Dates, Transitional Rules, Restrictions On Plan Distributions, and Other issues Arising Under the Retirement Equity Act of 1984.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to the effective dates, transitional rules, restrictions on distributions from employee plans, and other issues arising under the Retirement Equity Act of 1984 [Pub. L. 98-397, 1984-2 C.B. 433]. The regulations will generally affect sponsors of, and participants in, pension, profit-sharing, and stock bonus plans, and they provide plans sponsors with guidance necessary to comply with the law.

In addition, the text of the temporary regulations set forth in this document also serves as the text of the notice of proposed rulemaking that appears * * * [on page 761, this Bulletin].

DATES: The regulations are effective July 19, 1985, and generally apply for plan years beginning after December 31, 1984, except as otherwise specified in the Retirement Equity Act of 1984.

FOR FURTHER INFORMATION CONTACT: Charles M. Watkins of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention CC:LR:T) (202-566-3903, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains temporary regulations relating to the requirements for payment of survivor annuities, to restrictions on payments under qualified employee plans, and other rules, as enacted by Titles II and III of the Retirement Equity Act of 1984 ("REA '84") (P.L. 98-397, 98 Stat. 1436 *et seq.*).

Taxpayers may rely on these temporary regulations for guidance pending the issuance of final regulations. These temporary regulations do not, however, address comprehensively the issues raised by Titles II and III of REA '84, and no inferences should be drawn by reason of the fact that an issue is not addressed in this Treasury decision.

Under section 101 of Reorganization Plan No. 4 of 1978 (43 FR 47713), the Secretary of the Treasury has jurisdiction over the subject matter addressed in these regulations (except the definition of a qualified domestic relations order). Therefore, under section 104 of the Reorganization Plan, these regulations apply when the Secretary of Labor exercises authority under Title I of the Employee Retirement Income Security Act of 1974 (as amended, including the amendments made by Title I of REA) ("ERISA"). Thus, the requirements also apply to employee plans subject to Title I of ERISA.

NEW REQUIREMENTS

Sections 411(a)(11) and 417(e) of the Internal Revenue Code restrict a plan's ability to distribute benefits to participants and, when applicable, spouses. Section 411(a)(11) treats as forfeitable, for purposes of section 411(a), any accrued benefit that may be distributed to a participant without the participant's consent when the present value of the participant's nonforfeitable accrued benefit in the plan exceeds $3,500. Section 417(e) prohibits any plan subject to section 401(a)(11) from distributing any portion of a qualified joint and survivor annuity (QJSA), or a qualified preretirement survivor annuity (QPSA), if the present value of such an annuity is greater than $3,500, without the consent of the participant and the participant's spouse. Under sections 411(a)(11) and 417(e), the present value of a participant's annuity benefit in a defined benefit plan is to be determined by reference to an interest rate that is not greater than the interest rate used by the Pension Benefit Guaranty Corporation (PBGC) in valuing immediate annuities on plan termination. Plans are required to use this PBGC interest rate for both determining whether the $3,500 floor is reached and valuing the accrued benefit.

Defined contribution plans, such as money purchase, profit-sharing, and stock bonus plans, whether or not subject to section 401(a)(11), are required to use interest rates that are not greater than the PBGC rates to calculate the amount to be distributed, even if such plans use an account balance to purchase an annuity.

The regulations provide that, for purposes of sections 401(a)(11), 411(a)(11), and 417, a participant's accrued benefit includes benefits attributable to both employer and employee contributions under the plan, excluding

deductible employee contributions described in section 72(o).

The regulations also provide two rules governing when a reduction in an accrued benefit to satisfy a participant's loan obligation to the plan is treated as a distribution from the plan. Such a reduction is generally subject to the applicable consent requirements of sections 411(a)(11) and 417(e). Alternatively, a plan may obtain the consent of the participant and the participant's spouse to a subsequent reduction in accrued benefits within the 90 day period before the making of a loan secured by an accrued benefit.

The Department of Labor has jurisdiction over the prohibited transaction rules of section 4975. It has indicated that a loan secured by an accrued benefit subject to REA '84 may not be adequately secured under section 4975(d)(1) if consent to a reduction in the accrued benefit is not obtained before such a loan is made, and, therefore, may be a prohibited transaction.

PLAN AMENDMENTS

Plan amendments required by the Retirement Equity Act of 1984 must, in general, be adopted not later than the end of the first plan year to which the statutory provisions generally apply.

NONAPPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this regulation is not subject to review under Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required.

REGULATORY FLEXIBILITY ACT

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for temporary regulations. Accordingly, this regulation does not constitute a regulation subject to the Regulatory Flexibility act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal authors of these regulations are William D. Gibbs and Charles M. Watkins, of the Employee PLans and Exempt Organizations Division of the Office of the Chief Counsel, Internal Revenue Service. Personnel from other offices of the Internal Revenue Service and Treasury Department also participated in developing the regulations, on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph 1. The authority citation for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805.

Part 2. A new §1.401(a)-11T is added immediately after §1.401(a)-11 to read as follows:

§1.401(a)-11T Requirement of qualified joint and survivor annuity and qualified preretirement survivor annuity (Temporary).

Q-1: Are there new survivor annuity requirements added to the Code by the Retirement Equity Act of 1984 (REA '84) to protect spouses?

A-1: Yes. REA '84 replaced section 401(a)(11) with a new section 401(a)(11) must comply with the requirements of section 401(a)(11) and section 417 in order to remain qualified under section 401(a) or 403(a). In general, these plans must now provide both a qualified joint and survivor annuity (QJSA) and a qualified preretirement survivor annuity (QPSA) to remain qualified. These new survivor annuity requirements are applicable to any benefit payable under a plan, including benefits payable to a participant under a contract purchased by the plan and paid by a third party. Thus, an annuity contract purchased by a plan and distributed to or owned by the participant must comply with the new survivor annuity requirements as they would apply to the plan if the benefits were paid directly by the plan.

Q-2: What plans are subject to sections 401(a)(11) and 417?

A-2: Sections 401(a)(11) and 417 apply to any defined contribution plan that is subject to the minimum funding standards of section 412. These sections also apply to any participant under any other defined contribution plan unless—

(a) The plan provides that the participant's nonforfeitable accrued benefit is payable in full, upon the participant's death, to the participant's surviving spouse (unless the participant has elected, with spousal consent that satisfies the requirements of section 417(a)(2), that such benefit be provided instead to a designated beneficiary);

(b) Such participant does not elect the payment of benefits in the form of a life annuity; and

(c) With respect to the participant, the plan is not a transferee plan (see Q&As-7 and 8).

Section 401(a)(11)(C) provides that, for purposes of determining whether benefits under an employee stock ownership plan are subject to sections 401(a)(11) and 417, that portion of a participant's accrued benefit that is subject to section 409(h) is to be treated as though such benefit were provided under a defined contribution plan not subject to section 412.

Q-3: May a defined contribution plan not subject to section 412 that provides that a participant's nonforfeitable accrued benefit is payable in full to a surviving spouse use the rules set forth in section 417(d) for determining whether or not the participant is married at the time of death?

A-3: Yes.

Q-4: How do the survivor annuity requirements added by REA '84 apply to married participants?

A-4: Section 401(a)(11)(A) requires that upon the death of a married participant with vested benefits attributable to employer contributions, plan benefits with respect to such participant, except plan benefits the payment of which had commenced prior to the participant's death, must be paid in the form of a QPSA. A QPSA must be provided regardless of whether the participant separated from service before the date of death. Section 401(a)(11)(A) also requires that the plan benefits of a married participant who survives until commencement of payment of such benefits be provided in the form of a QJSA. The QPSA and the QJSA may be waived if the applicable notice, election, and spousal consent requirements of section 417 are satisfied. Thus, for example, in order for a money purchase pension plan to distribute any portion of a married participant's benefit to such participant—even if the distribution is merely an ad hoc distribution after the participant has attained the normal retirement age under the plan but

has not yet separated from service—the plan must distribute such portion in the form of a QJSA (unless the plan satisfies the applicable requirements of section 417(a) with respect to such portion of the participant's benefit). The plan still must satisfy the QPSA requirements with respect to any portion of the participant's benefits that has not been distributed, except any benefits the payment of which has commenced. However, if, prior to the commencement of a distribution of any benefits, the present value of such married participant's nonforfeitable accrued benefit is not more than $3,500, the requirements of section 417(a) need not be satisfied with respect to the payment of such participant's benefits. See §1.417(e)-1T.

Q-5: Must a plan subject to sections 401(a)(11) and 417 provide an annuity to participants who are not married?

A-5: Yes. Plans subject to the requirements of sections 401(a)(11) and 417 must satisfy those requirements with respect to participants who are not married. A QJSA for a participant who is not married is an annuity for the life of the participant, and thus, an unmarried participant must be provided such an annuity unless he elects another form of benefit.

Q-6: Must plans subject to new section 401(a)(11) meet other requirements?

A-6: Yes. Plans subject to new section 401(a)(11) must satisfy the requirements of section 417 (relating to minimum survivor annuity requirements).

Q-7: How do sections 401(a)(11) and 417 apply to transferee plans (certain defined contribution plans that are not subject to section 412)?

A-7: Although profit-sharing, stock bonus, and other defined contribution plans not subject to section 412 are generally not subject to sections 401(a)(11) and 417 with respect to their participants, these plans are subject to sections 401(a)(11) and 417 with respect to any participant if the plan is a transferee plan with respect to that participant. A defined contribution plan is a transferee plan with respect to a participant if the plan is a direct or indirect transferee, with respect to that participant, of benefits that were held, on or after January 1, 1985, by:

(a) A defined benefit plan;

(b) A defined contribution plan subject to section 412; or

(c) A defined contribution plan that is subject to sections 401(a)(11) and 417 with respect to that participant.

A transfer made before January 1, 1985, and any rollover contribution made at any time, is not a transfer that subjects a plan to the new survivor annuity rules with respect to a participant. If a plan is a transferee plan with respect to a participant, the section 417 requirements do not apply with respect to other plan participants solely because of the transfer. However, in order to prevent discrimination under section 401(a)(4), it may be necessary for the plan to provide QJSAs or QPSAs with respect to other participants.

Q-8: What benefits in a transferee plan are subject to the new survivor annuity requirements?

A-8: All accrued benefits held for a participant with respect to whom the plan is a transferee plan are subject to the new survivor annuity requirements unless there is an acceptable separate accounting between the transferred benefits and any other benefits under the plan. A separate accounting is not acceptable unless gains, losses, withdrawals, contributions, forfeitures, and other credits or charges are allocated between the accrued benefits subject ot the new survivor annuity requirements and other benefits on a reasonable and consistent basis. If there is an acceptable separate accounting between transferred benefits and any other benefits under the plan, only the transferred benefits are subject to the new survivor annuity requirements.

Q-9: Must annuity contracts purchased and distributed to a participant or spouse by a plan subject to sections 401(a)(11) and 417 satisfy the requirements of those sections?

A-9: Yes. No rights to accrued benefits, optional forms of payments, consents, or other privileges provided for by section 401(a)(11) or 417 may be eliminated or reduced because the plan uses annuity contracts to provide benefits or because such a contract is held by a participant or spouse instead of a plan trustee. Similarly, the protection provided by section 411(d)(6) may not be eliminated or reduced by the use of annuity contracts.

Q-10: If a plan would otherwise be subject to the survivor annuity requirements of new sections 401(a)(11) and 417, does the fact that it is frozen or terminated make a difference?

A-10: In general, benefits provided under a plan that is subject to the new survivor annuity requirements of sections 401(a)(11) and 417 must be provided in accordance with those requirements even if the plan is terminated or frozen. However, any plan that has a termination date prior to September 17, 1985 and that distributes all remaining assets as soon as administratively feasible after the termination date is not subject to the new survivor annuity requirements. The date of termination is determined under section 411(d)(3) and §1.411(d)-2(c).

Q-11: If a plan would otherwise be subject to the survivor annuity requirements of new sections 401(a)(11) and 417, does it make a difference that the Pension Benefit Guaranty Corporation (PBGC) is administering the plan?

A-11: No. Participants and spouses are entitled to the same protection irrespective of whether an employer or the PBGC is administering a plan.

Q-12: Do the new survivor annuity requirements apply to benefits derived from both employer and employee contributions?

A-12: Yes. The new survivor annuity benefit requirements apply to benefits derived from both employer and employee contributions.

Q-13: To what benefits do the new survivor annuity requirements apply?

A-13: (a) *Defined benefit plans.* Sections 401(a)(11) and 417 apply only to benefits in which a participant was vested immediately prior to death. They do not apply to benefits in which a participant becomes vested by reason of death or to the proceeds of a life insurance contract maintained by the plan for a participant to the extent such proceeds exceed the present value of the participant's nonforfeitable accrued benefits existing immediately prior to death.

(b) *Defined contribution plans.* Sections 401(a)(11) and 417 apply to all vested benefits, whether vested before or upon death, payable under the plan, including the proceeds of insurance contracts.

Q-14: What preretirement survivor annuity benefits must a defined contri-

bution plan provide?

A-14: A defined contribution plan that is subject to sections 401(a)(11) and 417 must provide an annuity whose actuarial equivalent is not less than 50 percent of the nonforfeitable account balance of the participant as of the date of the participant's death. For this purpose, the nonforfeitable account balance of the participant includes amounts attributable to nonforfeitable employer contributions and amounts attributable to employee contributions.

Q-15: In determining whether amounts attributable to employer contributions to a defined contribution plan are nonforfeitable under sections 401(a)(11) and 417, does the rule of section 411(a)(3)(A) (permitting forfeitures on account of death) apply?

A-15: No. Therefore, sections 401(a)(11) and 417 apply to benefits that were nonforfeitable immediately prior to death (determined without regard to section 411(a)(3)(A)), as well as to benefits that become nonforfeitable at death.

Q-16: Do sections 401(a)(11) and 417 apply to accumulated deductible employee contributions, as defined in section 72(o)?

A-16: No. Accumulated deductible employee contributions are not subject to the new survivor annuity rules even though such contributions are made to a defined benefit or defined contribution plan that is subject to sections 401(a)(11) and 417.

Q-17: When do the new survivor annuity requirements apply to plans?

A-17: New sections 401(a)(11) and 417 generally apply to plan years beginning after December 31, 1984. Sections 302 and 303 of REA '84 provide specific effective dates and transitional rules under which the QJSA or QPSA (or pre-REA '84 section 401(a)(11)) requirements may be applicable to particular plans or with respect to benefits provided to particular participants. In general, the new section 401(a)(11) survivor annuity requirements do not apply with respect to a participant who does not have at least one hour of service or one hour of paid leave under the plan after August 22, 1984.

Q-18: Are there special effective dates for plans maintained pursuant to collective bargaining agreements?

A-18: Yes. Section 302(b) of REA '84 provides a special deferred effective date for such plans. Whether or not a plan is described in section 302(b) will be determined under the principles applied under section 1017(c) of the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1, 101]. In addition, a plan will not be treated as maintained under a collective bargaining agreement unless the employee representative satisfies section 7701(a)(46) of the Internal Revenue Code after March 31, 1984. Nothing in section 302(b) shall deny a participant or spouse the rights set forth in sections 303(c)(2), 303(c)(3), 303(e)(1), and 303(e)(2) of REA '84.

Q-19: What is one hour of service or paid leave under the plan for purposes of the transition rules in section 303 of REA '84?

A-19: One hour of service or paid leave under the plan is one hour of service or paid leave recognized or required to be recognized under the plan for any purpose, *e.g.*, participation, vesting percentage, or benefit accrual purposes. For plans that do not compute hours of service, one hour of service or paid leave means any service or paid leave recognized or required to be recognized under the plan for any purpose.

Q-20: Must a plan be amended to provide for the QPSA required by section 303(c)(2) of REA '84, or for the survivor annuities required by section 303(e) of REA '84?

A-20: A plan will not fail to satisfy the qualification requirements of section 401(a) or 403(a) merely because it is not amended to provide the QPSA required by section 303(c)(2) or the survivor annuities required by section 303(e). The plan must, however, satisfy those requirements in operation. In addition, the plan must be amended to satisfy sections 401(a)(11) and 417 not later than the last day of the first plan year to which sections 401(a)(11) and 417 apply.

Q-21: Is a participant's election, or a spouse's consent to an election, with respect to a QPSA, made before August 23, 1984, valid?

A-21: No.

Q-22: Is spousal consent required for certain survivor annuity elections made by the participant after December 31, 1984, and before the first plan year to which new sections 401(a)(11) and 417 apply?

A-22: Yes. Section 303(c)(3) of REA '84 provides that any election by a participant, made after December 31, 1984, and before the date sections 401(a)(11) and 417 apply to the plan, not to take a QJSA is not effective unless the spousal consent requirements of section 417 are met with respect to such election. Unless the participant's annuity starting date occurred before January 1, 1985, the spousal consent required by section 417(a)(2) and (e) must be obtained even though the participant elected the benefit prior to January 1, 1985. By the end of the first plan year to which new sections 401(a)(11) and 417 apply, the plan must be amended to comply with the QJSA requirements.

Par. 3. A new §1.401(a)-13T is added immediately after §1.401(a)-13 to read as follows:

§1.401(a)-13T Assignment or alienation of benefits; special rules for qualified domestic relations orders (Temporary).

(a) *Definition.* The term qualified domestic relations order (QDRO) has the meaning set forth in section 414(p). For purposes of the Internal Revenue Code, a QDRO also includes any domestic relations order described in section 303(d) of the Retirement Equity Act of 1984, as provided in that section.

(b) *Plan amendments.* A plan will not fail to satisfy the qualification requirements of section 401(a) or 403(a) merely because it is not amended to require the plan to comply with a QDRO.

Par. 4. A new §1.410(a)-5T is added immediately after §1.410(a)-5 to read as follows:

§1.410(a)-5T Five consecutive 1-year breaks in service, transitional rules under the Retirement Equity Act of 1984 (Temporary).

Sections 410(a)(5)(D) and 411(a)(6)(D), as amended by the Retirement Equity Act of 1984 (REA '84), permit a plan to disregard years of service that were disregarded under plan provisions satisfying those sections (as in effect on August 22, 1984), as of the day before the amendments apply to the plan. Under section 302(a) of REA '84, the new break in service

rules generally apply to plan years beginning after December 31, 1984. Thus, for example, assume a plan has a calendar plan year and disregarded years of service as permitted by sections 410(a)(5)(D) and 411(a)(6)(D) as in effect on August 22, 1984. An employee completed two years of service in 1981 and 1982, and then incurred two consecutive 1-year breaks in service in 1983 and 1984. The plan may disregard the prior years of service, even though the employee did not incur five consecutive 1-year breaks in service. On the other hand, assume the employee completed three consecutive years of service beginning in 1980, and incurred two 1-year breaks in service in 1983 and 1984. Because, as of December 31, 1984, the years of service credited before 1983 could not be disregarded, whether the plan may subsequently disregard those years of service would be governed by the rules enacted by REA '84.

Par. 5. Section 1. 411(a)-7(d)(4)(iv)(B) is amended by adding at the end thereof the following sentence: "Notwithstanding the above sentence, no defined benefit plan or defined contribution plan may require that repayments be made earlier than the end of a period of 5 consecutive one-year breaks in service."

Par. 6. A new §1.410(a)-7T is added immediately after §1.410(a)-7 to read as follows:

§1.410(a)-7T Elapsed time method; maternity and paternity absence (Temporary).

(a) *General rule.* For purposes of applying the rules of §1.410(a)-7 (relating to the elapsed time method of crediting service) to absences described in sections 410(a)(5)(E) and 411(a)(6)(E) (relating to maternity or paternity absence), the severance from service date of an employee who is absent from service beyond the first anniversary of the first date of absence by reason of a maternity or paternity absence described in section 410(a)(5)(E)(i) or 411(a)(6)(E)(i) is the second anniversary of the first date of such absence. The period between the first and second anniversaries of the first date of absence from work is neither a period of service nor a period of severance. This rule applies to maternity or paternity absences beginning on or after the first day of the first plan year in which the plan is required to credit service under sections 410(a)(5)(E) and 411(a)(6)(E).

(b) *Example.* The rules of this section are illustrated by the following example:

Assume an individual works until June 30, 1986; is first absent from employment on July 1, 1986, on account of maternity or paternity absence; and on July 1, 1989, performs an hour of service. The period of service must include the period from employment commencement date until June 30, 1987 (one year after the date of separation for any reason other than a quit, discharge, retirement, or death). The period from July 1, 1987, to June 30, 1988, is neither a period of service nor a period of severance. The period of severance would be from July 1, 1988 to June 30, 1989.

Par. 7. A new §1.411(a)(11)-1T is added after §1.411(a)-9 to read as follows:

§1.411(a)(11)-1T. Restrictions and valuations of distributions (Temporary.)

(a) *Scope.* Section 411(a)(11) restricts the ability of a plan subject to section 411 to distribute any portion of a participant's accrued benefits without the participant's consent. Section 411(a)(11) applies in determining whether a plan satisfies the nonforfeitability requirements of section 411(a).

(b) *General rules*—(1) *New requirements.* If a plan does not satisfy the participant consent requirement with respect to the immediate distribution of any participant's nonforfeitable accrued benefit with a present value in excess of $3,500, the entire accrued benefit is forfeitable for purposes of determining whether section 411(a) is satisfied.

(2) *Additional requirements.* The requirements of section 411(a)(11) and this section are in addition to the requirements of sections 401(a)(9) (relating to required distributions), 401(a)(14) (relating to benefit commencement), and 417 (relating to survivor benefits). Notwithstanding any provision to the contrary in section 401(a)(14) or §1.401(a)-14, the failure of a participant to consent to a distribution while a benefit is immediately distributable is deemed to be an election to defer commencement of payment of any benefit sufficient to satisfy section 401(a)(14) and §1.401(a)-14.

(c) *Consent, etc. requirements*—(1) *General rule.* Section 411(a)(11) permits plans subject to that section to provide for the distribution of any portion of a participant's nonforfeitable accrued benefits only if either the applicable consent requirements are satisfied or such distribution is not immediately distributable.

(2) *Consent.* Written consent of the participant is required before the commencement of the distribution of any part of an accrued benefit if the present value of the nonforfeitable portion of such benefit is greater than $3,500.

(3) *Accrued benefit.* The term "accrued benefit" has the same meaning as such term has under section 417(e) and the regulations thereunder.

(4) *Immediately distributable.* An accrued benefit is immediately distributable for purposes of section 411(a)(11) and this section if any part of the benefit may be distributed to the participant before the later of the normal retirement age (as defined in section 411(a)(8)) or age 62.

(5) *Death of participant.* Section 411(a)(11) does not apply after the death of the participant.

Par. 8. Section 1.411(d)-3 is amended by removing the second sentence of paragraph (a)(1).

Par. 9. A new §1.411(d)-3T is added immediately after §1.411(d)-3, to read as follows:

§1.411(d)-3T Class year plans; plan years beginning after 1984 (Temporary).

In the case of a class year plan, the rights of an employee who separates from service prior to the time such rights become nonforfeitable may be forfeited only if there is a 5-year break-in-service. A 5-year break-in-service is a period of five consecutive plan years beginning with the plan year in which the employee separates from service during which the employee is not employed on the last day of each plan year. For purposes of the preceding sentence, any plan year in which an individual is absent from work on the last day of the plan year by reason of an absence described in section 411(a)(6)(E)(i) shall be disregarded.

Par. 10. A new §1.417(e)-1T is added to after §1.416-1 to read as follows:

§1.417(e)-1T Restrictions and

valuations of distributions from plans subject to section 401(a)(11) (Temporary).

(a) *Scope*—(1) *New requirements.* Section 417(e) restricts the ability of certain qualified plans to distribute any portion of a participant's accrued benefits without the consent of the participant and the participant's spouse. It also requires the present value of accrued benefits to be calculated using specified interest rates. Section 417(e) applies in determining whether certain plans satisfy the survivor annuity requirements of sections 401(a)(11) and 417. These requirements must be satisfied by pension plans with respect to all participants, and by profit-sharing and stock bonus plans with respect to participants to whom section 401(a)(11)(B) applies. Special rules are provided in section 401(a)(11)(C) for certain ESOP benefits. A plan does not satisfy the requirements of sections 401(a)(11) and 417 unless it satisfies the consent requirements, the determination of present value requirements and the other requirements set forth in this section. This section does not apply to payments to an alternate payee, defined in section 414(p)(8), except as provided in a qualified domestic relations order pursuant to section 414(p)(5).

(2) *Additional requirements.* The requirements of section 417(e) and this section are in addition to the requirements of sections 401(a)(9) (relating to required distributions), 401(a)(14) (relating to benefit commencement), and 411(a)(11) (relating to distributions). Notwithstanding any provision to the contrary in section 401(a)(14) or §1.401(a)-14, the failure of a participant or spouse to consent to a distribution while a benefit is immediately distributable is deemed to be an election to defer commencement of payment of any benefit sufficient to satisfy section 401(a)(14) and §1.401(a)-14.

(3) *Accrued benefit.* For purpose of this section, accrued benefit has the same meaning as specified in section 411(a)(7). The present value of an accrued benefit or annuity includes benefits attributable to both employee and employer contributions. Because section 401(a)(11) is not applicable to accumulated deductible employee contributions described in section 72(o), such accumulated contributions are not part of the accrued benefit. The value of an accrued benefit does not include any plan subsidy included in the present value of the qualified joint and survivor annuity (QJSA) or in the present value of the qualified preretirement survivor annuity (QPSA).

(b) *Consent, etc. requirements*—(1) *General rule.* Section 417(e) prohibits plans subject to that section from permitting the commencement of any distribution of any portion of a participant's accrued benefits unless—

(i) The applicable consent requirements are satisfied; or

(ii) (A) Such distribution is provided in the form of a qualified joint and survivor annuity (QJSA) or a qualified preretirement survivor annuity (QPSA); and

(B) Such benefit is not immediately distributable as described in paragraph (b)(3) of this section.

The consent requirement is applicable to accrued benefits that are immediately distributable.

(2) *Consent.* (i) Written consent of the participant and, if the participant is married at the time of the commencement of the distribution of benefits, the participant's spouse (or, if either the participant or the spouse has died, the survivor) is required before the commencement of the distribution of any part of an accrued benefit if the present value of the nonforfeitable accrued benefit is greater than $3,500. Such present value will be treated as greater than $3,500 at all times after the commencement of a distribution of benefits that was subject to this consent requirement. No consent is required before the commencement of the distribution of benefits if the present value of the nonforfeitable accrued benefit is not more than $3,500.

(ii) In determining the present value of the nonforfeitable accrued benefit, a defined benefit plan must use an interest rate not greater than the rate used by the Pension Benefit Guaranty Corporation (PBGC) to value immediate annuities for plans terminating as of either (A) the proposed distribution (or benefit commencement) date or (B) the first day of the plan year that contains the proposed distribution (or benefit commencement) date (the PBGC rate).

(3) *Immediately distributable.* An accrued benefit is immediately distributable if any part of the benefit could be distributed to the participant or beneficiary before that participant attains (or would have attained if not dead) the later of normal retirement age (as defined in section 411(a)(8)) or age 62.

(4) *Time of consent.* Written consent of the participant and the participant's spouse to the distribution must be obtained not more than 90 days before the commencement of the distribution of any part of an accrued benefit. See paragraph (d) of this section for a special rule for loans.

(5) *Other rules.* Except as provided in paragraphs (b)(2) and (d) of this section, the commencement of any distribution (including loans) permitted under section 417(e) and this section is subject to the election, spousal consent, and written explanation requirements of section 417(a).

(c) *Permitted distributions*—(1) *In general.* A plan may not require that a participant or surviving spouse begin to receive benefits without satisfying paragraph (b) of this section while such benefits are immediately distributable, as defined in paragraph (b)(3) of this section. Once benefits are no longer immediately distributable, all benefits must be provided in the form of a QJSA and QPSA unless the applicable written explanation, election, and consent requirements of section 417(a) are satisfied.

(2) *Special rule.* (i) In the case of a defined benefit plan, the plan must permit the surviving spouse to direct the commencement of payments under the QPSA no later than the month in which the participant would have attained the earliest retirement age under the plan. A plan may permit the commencement of payments at an earlier date.

(ii) In the case of a defined contribution plan, the plan must permit the surviving spouse to direct the commencement of payments under the QPSA within a reasonable time after the participant's death.

(3) *Unmarried participant.* In the case of a participant who is not married, the term "QJSA" means an annuity for the life of a participant.

(d) *Loans*—(1) *General rule.* (i) A loan from a plan to a participant shall not be treated as a distribution for purposes of this section. However, the re-

duction of an account balance or the present value of an accrued benefit to satisfy an obligation of a participant arising in connection with a loan from a plan to a participant is a distribution to the participant requiring the consent of the participant and spouse (if any) at the time of the reduction. The preceding sentence also applies to loans described in section 72(p)(4).

(ii) For purposes of satisfying the consent requirement with respect to a loan that is secured by a married participant's accrued benefit, a plan may require the participant and spouse to consent to the loan and the possible reduction in the accrued benefit within the 90-day period before the making of the loan. Thus, if spousal consent is obtained at the time of making a plan loan to a married participant, spousal consent is not required at the time of any setoff of the loan against the accrued benefit resulting from nonpayment, even though the participant is married to a different spouse at the time of the setoff. Similarly, in the case of an unmarried participant, the consent requirement may be satisfied by requiring the participant's consent to the loan and the possible reduction in the accrued benefit within the 90-day period before the making of the loan, even if the participant is married at the time of any setoff of the loan against the accrued benefit.

(iii) If the plan does not obtain consent of a current spouse at the time of a loan secured by some portion of the participant's accrued benefit, the plan will not be certain that it will be able to execute on the security by reducing the participant's accrued benefit without violating section 417(e). Thus the plan (depending upon whether there is other security for the loan) may have made a loan that is not adequately secured. See sections 401(a)(13) and 4975.

(2) *Renegotiation, etc.* For purposes of this paragraph (d), any renegotiation, extension, renewal, or other revision of a loan shall be treated as a new loan made on the date of the renegotiation, extension, renewal, or other revision.

(3) *Effective date.* This paragraph does not apply to loans made prior to August 19, 1985.

(e) *Present value requirement*—(1) *Interest rate.* For purposes of determining the present value of any accrued benefit and for purposes of determining the amount (subject to section 415) of any distribution, a defined benefit plan must use an interest rate not greater than the PBGC rate determined in the same manner and time as set forth in paragraph (b)(2)(ii). The same rate must be used for both purposes.

(2) *Other rules.* (i) In the case of a defined benefit plan that assumes a rate other than the PBGC rate, the rate producing the greater benefit (subject to section 415) must be used.

(ii) Any change in a rate described in subparagraph (1) is subject to section 411(d)(6).

(3) *Exceptions.* (i) Subparagraphs (1) and (2)(i) do not apply to a distribution under a non-decreasing annuity payable for a period not less than the life of the participant or, in the case of a QPSA, the life of the surviving spouse. A non-decreasing annuity includes an annuity that decreases merely because of the cessation or reduction of Social Security supplements or qualified disability payments (as defined in section 411(a)(9)).

(ii) Subparagraphs (1) and (2)(i) do not apply to any payment under a QJSA or QPSA.

(4) *Defined contribution plans.* Because the accrued benefit in a defined contribution plan equal the account balance, such plans are not subject to the interest rate requirements of this paragraph (e), even though they are subject to section 401(a)(11).

(f) *Special rules for annuity contracts*—(1) *General rule.* Any annuity contract purchased by a plan subject to section 401(a)(11) and distributed to or owned by a participant must provide that benefits under the contract are provided in accordance with the applicable consent, present value, and other requirements of this section applicable to the plan.

(2) *Effective date.* This paragraph does not apply to contracts distributed to or owned by a participant prior to September 17, 1985, unless additional contributions are made under the plan by the employer with respect to such contracts.

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impractical to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 USC 7805).

JAMES I. OWENS,
Acting Commissioner of Internal Revenue.

Approved July 3, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 18, 1985, 8:45 a.m., and published in the issue of the Federal Register for July 198, 1985, 50 F.R. 29371)

Section 402.—Taxability of Beneficiary of Employees' Trust

26 CFR 1.402(f)-1T: Required explanation of rollovers, capital grains, and ten-year averaging tax treatment (Temporary).

Plan administrators are required to give recipients of certain distributions written notice of the rules relating to the tax treatment of the distributions. See T.D. 8037, page 127.

Section 403.—Taxation of Employee Annuities

26 CFR 1.403(a)-1: Taxability of beneficiary under a qualified annuity plan.

Procedure for determining whether an employer that establishes or maintains a qualified plan under this section is subject to the requirements of section 414(m) or 414(n) of the Code. See Rev. Proc. 85-43, page 501.

Section 408.—Individual Retirement Accounts

26 CFR 1.408-1: General rules.

Procedure for determining whether an employer that establishes or maintains a simplified employee pension described in section 408(k) of the Code is subject to the requirements of section 414(m) or 414(n) of the Code. See Rev. Proc. 85-43, page 501.

Subpart B.—Special Rules

Section 410.—Minimum Participation Standards

26 CFR 1.410(a)-1: Minimum participation standards; general rules.

Procedure for determining whether an employer that establishes or maintains a qualified plan is subject to the requirements of section 414(m) or 414(n) of the Code and satisfies the minimum participation standards of this section. See Rev. Proc. 85-43, page 501.

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26 CFR 1.410(a)-1: Minimum participation standards; general rules.

Whether a defined benefit plan properly credits years of service for purposes of participation under section 410 of the Code. See Rev. Rul. 85-130, this page.

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26 CFR 1.410(a)-5T: Five consecutive 1-year breaks in service, transitional rules under the Retirement Equity Act of 1984 (Temporary).

Effective dates, transitional rules, restrictions on distributions, and other issues arising under the Retirement Equity Act of 1984. See T.D. 8038, page 130.

Section 411.—Minimum Vesting Standards

26 CFR 1.411(a)-1: Minimum vesting standards; general rules.

Procedure for determining whether an employer that establishes or maintains a qualified plan is subject to the requirements of section 414(m) or 414(n) of the Code and satisfies the minimum vesting standards of this section. See Rev. Proc. 85-43, page 501.

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26 CFR 1.411(a)-5: Service included in determination of nonforfeitable percentage. (Also Sections 401, 410; 1.401-1, 1.410(a)-1.)

Qualification; vesting; credit for all years of service. A multiple employer defined benefit plan must credit employees for all years of service whether or not an employer makes the required contributions to the plan. A plan that does not credit all years of service does not provide definitely determinable benefits as required by section 1.401-1(b)(1)(i) of the regulations and does not satisfy the minimum participation and vesting standards of sections 410 and 411 of the Code.

Rev. Rul. 85-130

ISSUES

(1) Whether a plan that credits service as described below provides definitely determinable benefits as required by section 1.401-1(b)(1)(i) of the Income Tax Regulations.

(2) Whether the plan satisfies the requirements of sections 410 and 411 of the Internal Revenue Code.

FACTS

A multiple employer defined benefit plan provides that any service attributable to periods for which an employer did not make required contributions to the plan shall not be credited to the employer's employees for purposes of determining eligibility to participate, vesting, or benefit accruals.

LAW AND ANALYSIS

Section 1.401-1(b)(1)9i) of the regulations defines a qualified pension plan as a plan established and maintained by an employer to provide definitely determinable benefits to its employees.

Rev. Rul. 74-385, 1974-2 C.B. 130, provides that in the case of a defined benefit pension plan, benefits will be considered definitely determinable if the plan contains an express formula under which each participant's benefit can be computed and such formula is not subject to employer discretion.

Although the plan in this case contains a formula for determining participants' benefits, benefits are actually determined under that formula only to the extent that the employer, in its discretion, makes required contributions.

Sections 410 and 411 of the Code establish minimum participation, vesting, and benefit accrual standards. Under these sections, an employee's eligibility to participate, vesting, and benefit accruals are based on years of service.

Section 1.410(a)-1(b)(5) of the regulations (relating to minimum participation standards) provides that rules relating to years of service and breaks in service are found in Part 2530 of the Department of Labor Regulations (relating to minimum standards).

Section 1.411(a)-6 of the regulations (relating to vesting) and section 1.411(b)-1(f) (relating to benefit accruals) also refer to Part 2530 of the Department of Labor Regulations for the purpose of computing service for vesting and benefit accrual.

Section 2530.210(c) of the Department of Labor Regulations provides rules for determining years of service in a multiple employer plan. Section 2530.210(c)(3)(i) defines multiple employer plan to include a multi-employer plan as defined in section 414(f) of the Internal Revenue Code. Section 2530.210(c)(1) provides that, generally, for purposes of determining eligibility to participate and vesting, all service with the employer or employers maintaining the plan shall be taken into account. Section 2530.210(c)(2) provides that, generally, for benefit accrual purposes, all covered service with the employer or employers maintaining the plan shall be taken into account.

The minimum participation, vesting, and benefit accrual standards of sections 410 and 411 of the Code were generally designed to protect the employee-participants' pension benefits after many years of service with an employer. The years of service provisions of section 2530.210(c)(1) and (2) therefore require that the plan provide credit for all covered service with the employer or employers maintaining the plan. An employer that is required by the plan document or collective bargaining agreement to contribute to the plan is an employer maintaining the plan for purposes of determining an employee's years of service whether or not the required contributions are made. To conclude otherwise would enable the employer to effectively circumvent the minimum participation, vesting, and benefit accrual standard by merely failing to make a required plan contribution.

In this case, the plan does not credit service for years in which the employer fails to make the required contributions.

HOLDINGS

(1) This plan does not provide definitely determinable benefits as required by section 1.401-1(b)(1)(i) of the regulations.

(2) The crediting of service under this plan does not satisfy the requirements of sections 410 and 411 of the Code.

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26 CFR 1.411(a)(11)-1T: Restrictions and valuations of distributions (Temporary).

Effective dates, transitional rules, restrictions on distributions, and other issues arising under the Retirement Equity Act of 1984. See T.D. 8038, page 130.

Section 412.—Minimum Funding Standards

26 CFR 1.412(c)(3)-1: Reasonable funding methods.

Funding; unit credit method; allocation of liabilities. The allocation of liabilities under the unit credit (accrued benefit) method to past and future service must take into account the requirements of section 415 of the Code. A version of the unit credit method that did not take into account section 415 is not a reasonable funding method.

Rev. Rul. 85-131

ISSUE

Whether the version of the unit credit (accrued benefit) funding method described below, under which certain liabilities are allocated to the current plan year rather than to prior plan years, is a reasonable funding method under section 1.412(c)(3)-1 of the Income Tax Regulations?

FACTS

A defined benefit pension plan was established effective January 1, 1983. The taxable year of the employer and the plan year both coincide with the calendar year. The plan provides that a participant's normal retirement benefit (payable as a life annuity at age 65) is 50 percent of the participant's high three consecutive years' compensation. However, the plan also provides that the accrued benefit of a participant at any time is 50 percent of the participant's high three consecutive years' compensation at that time, subject to the maximum benefit limitation under section 415(b)(1) of the Internal Revenue Code (which is explicitly stated in the plan). This limitation prohibits the accrual of an annual benefit in excess of the lesser of 100 percent of a participant's high three consecutive years' compensation at such time or $90,000. Further, section 415(b)(5) of the Code provides that, for a participant with less than 10 years of service with the employer, the maximum benefit limitation determined under section 415(b)(1) of the Code is reduced to an amount equal to that limitation (before such reduction) multiplied by a fraction, the numerator of which is the number of years (or part thereof) of service with the employer and the denominator of which is 10.

A version of the unit credit (accrued benefit) funding method is used to determine plan costs for the 1983 plan year for purposes of sections 404 and 412 of the Code. The method determines the projected retirement benefit and allocates all of such benefit to the first year of participation in the plan. Because of this allocation, the normal cost of the plan for the 1983 plan year is the present value of the projected retirement benefits.

LAW

Section 412(c)(3) of the Code provides that all costs, liabilities, rates of interest, and other factors under a plan shall be determined on the basis of actuarial methods which are reasonable.

Section 1.412(c)(3)-1(c)(5) of the regulations provides that under a reasonable funding method that allocates liabilities among different elements of past and future service, the allocation of liabilities must be reasonable.

Section 1.412(c)(3)-1(e) of the regulations provides special rules for a funding method that determines normal cost as an amount equal to the present value of benefits accruing under the method for a particular plan year. The unit credit funding method is a method that determines normal cost in this manner.

Section 1.412(c)(3)-1(e)(3) of the regulations provides that, in determining a plan's normal cost and accrued liability for a particular plan year, the projected benefits of the plan must be allocated between past and future years. Except in the case of a career average pay plan, the allocation of projected benefits of the plan between past years and future years must be in proportion to the applicable rates of benefit accrual under the plan. Thus, the allocation to past years is effected by multiplying the projected benefit by a fraction, the numerator of which is the participant's credited years of service and the denominator of which is the participant's total credited years of service at the anticipated benefit commencement date. However, in formulating this fraction, adjustments are made to account for changes in the rate of benefit accrual.

ANALYSIS

For an employee who was hired on January 1, 1983, and commenced participation on that date, the benefit that accrues under the plan described above for the first plan year is the lesser of 10 percent (100 percent multiplied by 1/10) of high three consecutive years' compensation at such time or $9,000 ($90,000 multiplied by 1/10). If the plan provided a greater benefit accrual in such plan year, the plan would exceed the maximum benefit limitation described in section 415(b)(1) of the Code. Accordingly, for purposes of section 1.412(c)(3)-1(e) of the regulations and pursuant to the limitation under section 415(b)(5) of the Code, the plan is viewed as providing a rate of benefit accrual equal to 10 percent of compensation (subject to the dollar limitation of section 415(b)(1) of the Code) for each year of the participant's first five years of service.

For an employee with four years of service on January 1, 1983, the benefit that accrues under the plan described above in the first plan year (*i.e.*, the employee's fifth year of service) is the lesser of 50 percent (100 percent multiplied by 5/10) of high three consecutive years' compensation at such time or $45,000 ($90,000 multiplied by 5/10). Of this accrued benefit, the lesser of 40 percent of high three consecutive years' compensation as of the end of the first plan year or $36,000 is provided by the plan due to past years of service. Thus, for purposes of section 1.412(c)(3)-1(e) of the regulations, the initial accrued liability for this employee under the unit credit funding method (assuming 25 credited years of service at the anticipated benefit commencement date), after applying the fraction described in section 1.412(c)(3)-1(e)(3) of the regulations, is the present value of the lesser of 40 percent of high three consecutive years' compensation as of the anticipated benefit commencement date or $36,000. The 40 percent amount is calculated in the following manner:

$$\text{50 percent of compensation as of benefit commencement} \times \frac{(4 \times 10)}{(5 \times 10) + (20 \times 0)}.$$

See example (5) of section 1.412(c)(3)-1(g) of the regulations.

Similarly, for any employee with other than four years of service on January 1, 1983, any benefit that accrues under the plan described above in the first plan year in excess of the lesser of 10 percent of high three consecutive years' compensation as of such time or $9,000 is only on account of past service. Thus, for purposes of section 1.412(c)(3)-1(e) of the regulations, the maximum benefit that may be treated as accruing in the first plan year for such an employee is the lesser of 10 percent of higher consecutive years' compensation as of the anticipated benefit commencement date or $9,000.

Under the version of the unit credit funding method utilized for the plan described above, the normal cost is determined as the present value of benefits accruing during the plan year. Thus, the funding method used for such plan allocates a participant's entire projected retirement benefit to the 1983 plan year (the first plan year) and allocates no liabilities to previous years. Because the funding method used for the plan does not reasonably allocate liabilities between past and future service in proportion to the applicable rates of benefit accrual under the plan, as illustrated by the preceding analysis, such method does not satisfy the requirements of section 1.412(c)(3)-1(e) of the regulations.

HOLDING

The allocation of liabilities between past and future years of service under the version of the unit credit funding method used for the plan described above does not satisfy the requirements of section 1.412(c)(3)-1(e)(3) of the regulations. Thus, the actuarial cost method utilized for the plan is not reasonable under section 412(c)(3) of the Code.

Section 413.—Collectively Bargained Plans, Etc.

Ct. D. 2032

SUPREME COURT
OF THE
UNITED STATES
No. 85-2157

Central States, Southeast & Southwest Areas Pension Fund et al. v. Central Transport, Inc., et al.
[472 U.S.]

On Writ of Certiorari to the
United States
Court of Appeals
for the Sixth Circuit

[June 19, 1985]

Syllabus

Petitioners are multiemployer benefit plans governed by the Employee Retirement Income Security Act of 1974 (ERISA) [Pub. L. 93-406, 1974-3 C.B. 1]. The plans operate under trust agreements for the purpose of providing health, welfare, and pension benefits to employees performing work that is covered by collective-bargaining agreements negotiated between a labor union and respondent trucking companies. Under these collective-bargaining agreements, each employer must make weekly contributions to petitioners for each such employee, and each employer agrees to be bound by the trust agreements. Because they are so large, petitioners rely on employer self-reporting to determine the extent of an employer's contribution liability, and police this self-reporting system by conducting random audits of the participating employers' records. When respondents refused to allow petitioners' requested audit of respondents' payroll, tax, and personnel records, including records of employees whom respondents claimed were not plan participants, petitioners filed an action in Federal District Court seeking an order permitting the audit. The District Court granted summary judgment in favor of petitioners. The Court of Appeals reversed, holding that petitioners had to show "reasonable cause" to believe that a specific employee was covered by the plans before gaining a right of access to that employee's records.

Held: Respondents must allow petitioners to conduct the requested audit.

(a) Various provisions of the trust agreements granting the trustees power to enable them to administer the trusts properly, including a provision granting power to demand and examine pertinent employer records, support the right to audit claimed by petitioners. Moreover, petitioners' assertion that the required audit is highly relevant to the trust agreements' legitimate interests fully conform to generally accepted auditing standards.

(b) Petitioners' trustees' interpretation of the trust agreements as authorizing the requested audit is not inconsistent with ERISA, and indeed, is entirely reasonable in light of ERISA's policies. Rather than explicitly enumerating all of the powers and duties of trustees, Congress invoked the common law of trusts to define the scope of their authority and responsibility. Under the common law, trustees have all such powers as are necessary or appropriate for the carrying out of the trust purposes, and an examination of ERISA's structure in light of the common law leaves no doubt as to the validity and weight of the audit goals on which petitioners rely. Both the concerns of fully informing participants of their rights and status under a plan and for assuring the financial integrity of the plans by determining the class of potential benefit claimants and by holding employers to the full and prompt fulfillment of their contribution obligations are proper and weighty within ERISA's framework.

(c) A benefit plan should not have to rely on union monitoring of an employer's compliance with its trust obligations as an alternative to audits by the plans themselves. *Cf. Schneider Moving & Storage Co.* v. *Robbins*, 466 U.S.___. A trustee's duty extends to all participants and beneficiaries of a multiemployer plan, whereas a union's duty is confined to current employees employed in the bargaining unit in which it has representational rights. Nor would the Department of Labor's policing of employer compliance be an acceptable alternative. That Department has insufficient resources for such policing, and neither ERISA's structure nor its legislative history shows any congressional intent that benefit plans should rely primarily on centralized federal monitoring of employer contributions requirements.

(d) To rely on covered employees themselves to come forward to assure that employers make the required contributions would not be feasible. While ERISA's reporting requirements are designed to assure that participants receive information about their status and rights, they do so by placing a report-

ing duty *on the plans*. Thus, to give participants initial notice of their status, the plans would need to know the participants' identities, the very information that the requested audit here sought to verify.

(e) The fact that a benefit plan could bring an action against a delinquent employer as the employer's breaches of its obligations are discovered does not foreclose the plan from seeking to deter such breaches or discover them early. To suggest that a plan should be so foreclosed ignores the trustees' various fiduciary duties under ERISA and conflicts with ERISA's concern that plans should assure themselves of adequate funding by promptly collecting employer contributions.

698 F.2d 802, reversed.

MARSHALL, J., delivered the opinion of the Court, in which BRENNAN, WHITE, BLACKMUN, POWELL, and O'CONNOR, JJ., joined. STEVENS, J., filed an opinion concurring in part and dissenting in part, in which BURGER, C. J., and REHNQUIST, J., joined.

JUSTICE MARSHALL delivered the opinion for the Court.

The issue presented is whether an employer who participates in a multiemployer benefit plan that is governed by the Employee Retirement Income Security Act of 1974, 29 U.S.C. §1001 *eq seq.*, must allow the plan to conduct an audit involving the records of employees whom the employer denies are participants in the plan.

I

A

Petitioners are two large multiemployer benefit plans, the Central States, Southeast and Southwest Areas Pension Fund and the Central States, Southeast and Southwest Areas Health and Welfare Fund (hereinafter referred to collectively as "'Central States").[1] Governed by §302(c)(5) of the Labor Management Relations Act, of 1947, 29 U.S.C. §186(c)(5) and the Employee Retirement Income Security Act of 1974 (ERISA), 88 Stat. 829, 29 U.S.C. 1001 *et seq.*, as amended by the Multiemployer Pension Plan Amendments Act of 1980, Pub. L. 96-364, 94 Stat. 1208 [1980 2 C.B. 437], these plans operate as trusts for the purpose of providing specified health, welfare, and pension benefits to employees performing work that is covered by collective-bargaining agreements negotated by various affiliates of the International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America (Teamsters).

Respondents (hereinafter referred to collectively as "Central Transport") are 16 interstate trucking companies, each of which, either individually or through a multiemployer association, engages in collective bargaining with the Teamsters. Pursuant to that bargaining, each has become a signatory to the National Master Freight Agreement and supplemental, individual collective-bargaining agreements. Under these collective-bargaining agreements, each employer must make weekly contributions to Central States for each employee who performs work covered by the collective-bargaining agreements, and each employer agrees to be bound by the trust agreements that govern Central States.

Because the plans are so large—with thousands of participating employers—Central States relies principally on employer self-reporting to determine the extent of an employer's liability.[2] Central States policies this self-reporting system by conducting random audits of the records of participating employers.

B

On December 5, 1979, Central States contacted Central Transport to arrange an audit, which it described as part of a program of "'periodic reviews of participating employer contributions for the benefit of Plan Participants and their Beneficiaries."' 522 F. Supp. 658, 662 (ED Mich. 1981). The audit was to take place at Central Transport's offices and was to encompass, among other subjects, the "'[d]etermination of eligible Plan Participants covered by Collective Bargaining Agreements.'" *Ibid.* Among the documents the auditors requested access to were payroll, tax, and other personnel records of those employees whom the employer claimed were not plan participants.

Central States explained that access to these records would allow the auditors independently to determine the membership of the class entitled to participate in the plans, and thus to verify that Central Transport was making all required contributions.[3] Central Transport, however, insisted that 60% of its employees were not covered by the plans, and that Central States had no right to examine any records of noncovered employees. When Central Transport refused to allow the requested audit, Central States filed an action in Federal District Court seeking an "order permitting its auditors to conduct an independent verification of Central Transport's complete payroll records in order to determine whether the duties and status of each of its employees has been accurately reported by Central Transport." *Id.*at 660.[4]

The parties agreed that the facts of the case were not in dispute, and that the court should treat their pleadings as cross motions for summary judgment. The District Court granted summary judgment in favor of Central States. After examining Central States' contractual relationship with Central Transport and Central States' responsibilities under ERISA, the court concluded that

[1]As the Court of Appeals noted, "The record . . . indicates that the Funds are among the largest Taft-Hartley trust funds in the United States, that more than 13,000 employers participate and that they serve more than 500,000 employees whose job classifications are covered in thousands of collective bargaining agreements." 698 F. 2d 802, 811 (1983). See also *Schneider Moving & Storage Co.* v. *Robbins*, 466 U.S. ___, ___ n. 16 (1984).

[2]The District Court described this system as follows:

"Traditionally, the Central States Funds have operated on a self-reporting basis, which required the employer to initially establish a base group of employees entitled to weekly contributions and then to inform [Central States] monthly of any fluctuations in the employment status of individuals covered by the collective bargaining agreement. Central States relies upon the status reports of [Central Transport] to compute an invoice statement which it forwards to Central Transport. Thus, when the employer reports the termination or layoff of an individual formerly covered by the collective bargaining agreement, Central States will adjust its records and reduce the defendant's invoice to reflect the reported change. Conversely, when an employer reports the addition of new employees, Central States will increase the invoice by an amount which corresponds to the weekly contribution figure multiplied by the number of weekly hired employees." 522 F. Supp. 658, 662 (ED Mich. 1981).

[3]See *infra*, at 6-8.

[4]The action was filed pursuant to §301(a) of the Labor Managment Relations Act of 1947, 29 U.S.C. §185(a), and §502 of ERISA, 29 U.S.C. §1132.

ntral States had a right to conduct
e requested audit. The audit was a
asonable means of "independently
rify[ing] the status and duties of all
lividuals employed by Central Trans-
rt in order to insure that proper bene-
contribution payments are being
de." *Id.*, at 660. The court thus or-
red "that Central Transport provide
the audit representatives of Central
ates all of the documentation re-
ested and that the audit procedure
dertaken by Central States be al-
ved to continue." *Ibid.*[5]

The Court of Appeal for the Sixth
rcuit reversed. 698 F. 2d 802 (1983).
erpreting the collective-bargaining
reement and trust documents in light
ERISA, the Court of Appeals held
t Central States had to show "rea-
nable cause" to believe that a specific
ployee was covered by the plans be-
re gaining a right of access to that
ployee's records. *Id.*, at 809-812.
e granted certiorari, 467 U.S. ___
984), and we now reverse the judg-
nt of the Court of Appeals.

II

The documents governing Central
nsport's contractual relationship
h Central States include the
llective-bargaining agreements be-
een Central Transport and various af-
ates of the Teamsters Union and the
st agreements of the Central States
ns. Generally, the collective-
gaining agreements obligate Central
nsport to participate in the Central
tes plans and to be bound by Central
ates' trust agreements. The trust
reements, which have been signed by
ntral Transport, govern the operation
the plans.

These trust documents include a
mber of provisions that are highly
pportive of the right to audit claimed
Central States' trustees.

A

We note first that the Pension Fund trust agreement[6] places on each participating employer the responsibility to make "continuing and prompt payments to the Trust Fund as required by the applicable collective bargaining agreement." App. to Pet. for Cert. A-44 (Art. III, §1). The trustees are designated the recipients of all contributions and are "vested with all right, title and interest in and to such moneys." *Ibid.* (Art. III, §3).

The agreement contains various specific and general grants of power to the trustees to enable them to administer the trusts properly. Most generally, the agreements authorize the trustees to "do all acts, whether or not expressly authorized . . ., which [they] may deem necessary or proper for the protection of the property held [under the trust agreement]." *Id.*, at A-47 (Art. IV, §14(e)). The agreement also grants broad powers relating to the collection of employer contributions, such as the power "to demand and collect the contributions of the Employers to the Fund," *id.*, at A-45 (Art. III, §4), and the power to "take such steps . . . as the Trustees in their discretion deem in the best interest of the Fund to effectuate the collection or preservation of contributions . . . which may be owed to the Trust Fund." *Ibid.*

Among the more specific grants of trustee power is a power to demand and examine employer records:

"Production of Records—Each employer shall promptly furnish to the Trustees, upon reasonable demand the names and current addresses of its Employees, their Social Security numbers, the hours worked by each Employee and past industry employment history in its files and such other information as the Trustees may reasonably require in connection with the administration of the Trust. *The Trustees may, by their representatives, examine the pertinent records of each Employer at the Employer's place of busines whenever such examination is deemed necessary or advisable by the Trustees in connection with the proper administration of the Trust.*" *Id.*, at A-46 (Art. III, §5) (emphasis added).

B

Central States' trustees interpret these provisions as authorizing random field audits like the one at issue in this case. In particular, they argue that the records of not-concededly-covered employees are "pertinent records" because their examination is a "proper" means of verifying that the employer has accurately determined the class of covered employees. The plans have a substantial interest in verifying the employer's determination of participant status, the trustees argue, because an employer's failure to report all those who perform bargaining unit work may prevent the plans from notifying participants and beneficiaries of their entitlements and obligations under the plans and may create unfunded liabilities chargeable against the plans.[7] Moreover, an employer has an incentive to underreport the number of employees covered, because such underreporting would reduce his liability to the plans.

The reasonableness and propriety of the audit is confirmed, the trustees argue, by the accounting profession's generally accepted auditing standards, which articulate the elementary principle that for an auditor to verify a certain selection decision, he must refer to a universe broader than the selection itself:

"When planning a particular sample, the auditor should consider the specific audit objective to be achieved and should determine that the audit procedure, or combination of procedures to be applied will achieve that objective. The auditor should determine that the population from which he draws the sample is appropriate for the specific audit objective. *For example, an auditor would not be able to detect under-*

In reaching its decision, the District Court "mindful of the fact that Central States ha[d] eatedly stated that confidential payroll data uld] not be copied or removed from the Cen- Transport premises once the auditors have sfied themselves that particular indivuals are performing [bargaining] unit work." 522 F. p. at 664.

[6]The trust agreement governing the Pension Fund and the trust agreement governing the Health and Welfare Fund are identical in all pertinent respects. References will therefore be made only to the Pension Fund trust agreement.

[7]The consistent view of the Secretary of Labor is that, under ERISA's minimum participation, vesting, and benefit accrual standards for pension plans, 29 U.S.C. §§1052, 1053, 1054, a pension plan covered by ERISA *must* award credit "solely on the basis of service performed for a participating employer, regardless [of] whether that employer is required to contribute for such service or has made or defaulted on his required contributions." In the Secretary's judgment, "Any plan term or Trustees' resolution to the contrary is . . . unlawful and unenforceable." Department of Labor Advisory Op. No. 76-89 (Aug. 31, 1976) (reprinted in App. to Pet. for Cert. A70-A71); accord, Department of Labor Advisory Op. No. 78-28A (Dec. 5, 1978) (reprinted in App., to Pet. for Cert. A71-A74).

statements of an account due to omitted items by sampling the recorded items. An appropriate sampling plan for detecting such understatements would involve selecting from a source in which the omitted items are included." American Institute of Certified Public Accountants, Codification of Statements on Auditing Standards, AU §350.17, p. 223 (1985) (emphasis added).

The trustees' determination that the trust documents authorize their access to the records here in disspute has significant weight, for the trust agreement explicitly provides that "any construction [of the agreement's provisions] adopted by the Trustees in good faith shall be binding upon the Union, Employees and Employers." App. to Pet. for Cert. A-48 (Art. IV, §17).[8] There has been no evidence of a bad-faith motive behind the trustees' determination of the scope of their powers under the trust agreements or behind their determination of the auditing program's propriety. The trustees assert that the requested audit is highly relevant to the trust's legitimate interests, and this assertion fully conforms to generally accepted auditing standards. Thus, if our inquiry were merely an inquiry into the trust agreement, the trustees' right to conduct the audit in question would seem clear.

III

The Court of Appeals, nonetheless, rejected the Central States trustees' interpretation of their contractual power. In the court's view, such an auditing power would be unreasonable in light of the policies and protections embodied in ERISA. We agree with the Court of Appeals that trust documents cannot excuse trustees from their duties under ERISA, and that trust documents must generally be construed in light of ERISA's policies, see 29 U.S.C. §1104(a)(1)(D), but we find no inherent inconsistency between ERISA and the interpretation of the trust agreements offered by the Central States trustees. Indeed, we find the trustees' interpretation of their documents to be entirely reasonable in light of ERISA's policies.

An examination of the duties of plan trustees under ERISA, and under the common law of trusts upon which ERISA's duties are based, makes clear that the requested audit is highly relevant to legitimate trustee concerns.

A

This Court has on a number of occasions discussed the policy concerns behind ERISA. In *Nachman Corp.* v. *Pension Benefit Guaranty Corp.*, 446 U.S. 359, 361 (1980), we noted that Congress enacted ERISA after "almost a decade of studying the Nation's private pension plans" and other employee benefit plans.[9] Congress found that there had been a "rapid and substantial" growth in the "size, scope, and numbers" of employee benefit plans and "that the continued well-being and security of millions of employees and their dependents are directly effected by these plans." 29 U.S.C. §1001(a). But it also recognized that "owing to the inadequacy of [pre-ERISA] minimum standards, the soundness and stability of plans with respect to adequate funds to pay promised benefits may [have been] endangered." *Ibid.* We have recognized that one of ERISA's principal purposes was "to correct this condition by making sure that if a worker has been promised a defined pension benefit upon retirement—and if he has fulfilled whatever conditions are required to obtain a vested benefit—he actually will receive it." 446 U.S., at 375. One of the methods of accomplishing this was the provision of "minimum standards" that would "assur[e] the equitable character of [employee benefit plans] and their financial soundness." 29 U.S.C. §1001(a).

B

In general, trustees' responsibilities and powers under ERISA reflect Congress' policy of "assuring the equitable character" of the plans. Thus, rather than explicitly enumerating *all* of the powers and duties of trustees and other fiduciaries, Congress invoked the common law of trusts to define the general scope of their authority and responsibility.[10] Under the common law of trusts, as under the Central States trust agreements, trustees are understood to have all "such powers as are necessary or appropriate for the carrying out of the purposes of the trust." 3 A. Scott, Law of Trusts §186, p. 1496 (3d ed. 1967) (hereinafter Scott).[11]

The manner in which trustee powers may be exercised, however, is further defined in the statute through the provision of strict standards of trustee conduct, also derived from the common law of trusts—most prominently, a standard of loyalty and a standard of care. Under the former, a plan fiduciary "shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and . . . for the exclusive purpose of providing benefits to particpants and their beneficiaries; and . . . defraying reasonable expenses of administering the plan." 29 U.S.C. §1104(a)(A). See also §1103(c)(1); cf §186(c)(5). Under

[8]Similarly, the collective-bargaining agreement provides that each employer is deemed to have "ratif[ied] all action already taken or to be taken by [Trustee] within the scope of their authority." 522 F. Supp., at 661 (quoting National Master Freight Agreement, Art. 60) A trust "participation agreement" entered into by Central Transport is of similar effect, providing that Central Transport "assent[s] to . . . all of the actions of the Trustees in administering such Trust Fund in accordance with the Trust Agreement and rules adopted." *Ibid.* (quoting paragraph one of the Pension Fund participation agreement).

[9]Although most of ERISA's legislative history focused on pension plans, Congress also studied the operation of other employee benefit plans and developed a similar regulatory framework respecting these other plans. For example, ERISA's rules concerning reporting, disclosure, and fiduciary responsibility apply to all employee benefit plans. See 29 U.S.C. §§1021-1031, 1101-1114. See also 29 U.S.C. §1001(a) (stating congressional findings and policies with respect to "employee benefit plans"); 29 U.S.C. §1002(3) (defining "employee benefit plan" as including both "pension benefit plan[s]" and "welfare benefit plan[s]"). See generally, *Shaw* v. *Delta Air Lines, Inc.*, 463 U.S. 85, 91 (1983).

[10]See, *e.g.*, 29 U.S.C. §1103(a) ("assets of an employee benefit plan shall be held in trust"); S. Rep. No. 93-127, 29 (1973) ("The fiduciary responsibility section, in essence, codifies and makes applicable to these fiduciaries certain principles developed in the evolution of the law of trusts"); H.R. Rep. No. 93-533, p. 11 (1973) (identical language); cf. *NLRB* v. *Amax Coal Co.*, 453 U.S. 322, 329-334 (1981) (Congress intended that union welfare funds regulated by the Taft-Hartley Act, see 29 U.S.C. §186(c)(5), be operated under traditional trust law principles and this desire became explicit in ERISA).

[11]Accord, G. Bogert & G. Bogert, Law of Trusts and Trustees §551, p. 41 (2d rev.ed. 1980) (hereinafter Bogert) (trustee has the power to use all "ordinary and natural means" for accomplishing the trust's objective); Restatement (Second) of Trusts §186(b) (1959) (hereinafter Restatement) (trustee has all powers "necessary or appropriate to carry out the purposes of the trust.").

the latter, a fiduciary "shall discharge his duties with respect to a plan . . . with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." §1104(a)(B).[12]

An examination of the structure of ERISA in light of the particular duties and powers of trustees under the common law leaves no doubt as to the validity and weight of the audit goals on which Central States relies. ERISA clearly assumes that trustees will act to ensure that a plan receives all funds to which it is entitled, so that those funds can be used on behalf of participants and beneficiaries, and that trustees will take steps to identify all participants and beneficiaries, so that the trustees can make them aware of their status and rights under the trust's terms.

C

One of the fundamental common-law duties of a trustee is to preserve and maintain trust assets, Bogert, *supra*, §582, at 346, and this encompasses "determin[ing] exactly what property forms the subject-matter of the trust [and] who are the beneficiaries." §583, at 348 (footnotes omitted). The trustee is thus expected to "use reasonable diligence to discover the location of the trust property and to take control of it without unnecessary delay." *Id.*, at 355.[13] A trustee is similarly expected to "investigate the identity of the beneficiary when the trust documents do not clearly fix such party" and to "notify the beneficiaries under the trust of the gifts made to them." *Id.*, at 348-349, n. 40.

The provisions of ERISA make clear that a benefit plan trustee is similarly subject to these responsibilities, not only as a result of the general fiduciary standards of loyalty and care, borrowed as they are from the common law, but also as a result of more specific trustee duties itemized in the Act. For example, the Act's minimum reporting and disclosure standards require benefit plans to furnish all participants with various documents informing them of their rights and obligations under the plan, see, *e.g.*, 29 U.S.C. §§1021, 1022, 1024(b),[14] a task that would certainly include the duty of determining who is in fact a plan participant.[15] The Act also requires that a benefit plan prevent participant employers from gaining even temporary use of assets to which the plan is entitled, see §1106(a)(1)(B) (prohibiting trustees from "caus[ing] the plan to engage in a transaction, if . . . such transaction constiutes a direct or indirect . . . extension of credit" to a participating employer), a requirement that would certainly create a trustee responsibility for assuring full and prompt collection of contributions owed to the plan.[16]

Moreover, that these trustee duties support the auditing authority claimed in this case is strongly suggested by the other provisions of ERISA as well as by the positions of the administrative agencies charged with the administration of the Act. For example, §209 of the Act supplements the benefit plans' duties to furnish reports to plan participants by requiring employers to maintain records on employees and to furnish to benefit plans the information needed for the plaas' fulfillment of their reporting duties. 29 U.S.C. §1059. The Secretary of Labor has explicitly interpreted the trustees' duty to prevent employer use of trust assets as creating a plan duty to verify employer determinations and requiring plans to adopt systems for policing employers. And the Secretary has endorsed the appropriateness of field auditing programs for this purpose. Thus, the Secretary notes that "many multiple employer plans have adopted written procedures for the orderly collection of delinquent employer contributions which involve reasonable, diligent and systematic methods for the review of employer contribution accounts by means of, for example, . . . field audits." In the Department's view, plans "which do not establish and implement [such] collection procedures" may "by failing to collect delinquent contributions" be found to have violated §406's prohibition of extensions of credit to employers. Prohibited Transaction Exemption 76-1, 41 Fed. Reg. 12740, 12741 (1976) [1976-1 C.B. 357]; accord, Department of Labor Advisory Op. No. 78-28A (Dec. 5, 1978) (reprinted at App. to Pet. for Cert. A71-A74).

In light of the general of the general policies behind ERISA as well as the particular provisions of the statute, we can only conclude that there is no conflict between ERISA and those concerns offered by Central States to justify its audit program. Both the concern for fully informing participants of their rights and status under a plan and the concern for assuring the financial integrity of the plans by determining the

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[12]In light of ERISA's standards, Central Transport correctly argues that the audit request would be illegitimate under the standard of loyalty if it were actually an effort by plan trustees to expand plan coverage beyond the class defined in the plans' terms or to acquire information about the employers to advance union goals. It similarly argues that the audit would be imprudent if it were clearly wasteful of plan assets or unrelated to legitimate plan concerns.

Central Transport, however, has submitted no evidence that Central States' audit program's actual goal was to expand the trust's coverage beyond that provided in the applicable collective-bargaining agreements or to acquire information for union goals; nor did it submit any evidence that the audits were unjustifiably costly. Thus, whether the auditing power claimed by Central States is consistent with ERISA must be analyzed in terms of the goal upon which Central States has rested its audit, that of policing Central Transport's "'[d]etermination of eligible Plan participants covered by Collective Bargaining Agreements,'" 522 F. Supp., at 662 (quoting Central States' letter to Central Transport), so as to verify that Central Transport is indeed contributing all required amounts on behalf of all covered employees.

[13]See also Bogert, *supra*, at 355 (where the settlor retains possession of trust assets, "the trustee must hold the settlor to [his] obligation"); 2 Scott, *supra*, §175, at 1415 ("trustee is under a duty to take such steps as are reasonable to secure control of the trust property and to keep control of it").

[14]See also 29 CFR §§2520.104b-1-2520.104b-30 (1984).

[15]That the reporting requirements presuppose a plan's knowledge of participants' identities is highlighted by the Labor Department's determination that to comply with the minimum reporting standards a plan "must [send the precribed material] by a method or methods of delivery likely to result in full distribution." 29 CFR §2520.104b-1 (1984). Mail distribution is one of the suggested methods, and more importantly, the Department cautions that "in no case is it acceptable [for a plan] merely to place copies of the material in a location frequented by participants" as a means for complying with ERISA's reporting requirements). *Ibid.*

[16]See also 29 U.S.C. §1103(c)(1) (providing that "the assets of a plan shall never inure to the benefit of any employer"); §1145 (requiring employers to fulfill the contribution obligations in accordance with the terms of plan documents). For a more detailed discussion of Congress concern for assuring full and prompt compliance with contribution obligations, see Part IV-C, *infra*.

class of potential benefit claimants and holding employers to the full and prompt fulfillment of their contribution obligations are proper and weighty within the framework of ERISA.

IV

The Court of Appeals offered a number of reasons why the requested audit would nevertheless be improper as a matter of law. The Court of Appeals largely relied on the presence of alternative means of protecting a plan's interests to conclude that a plan's access to employee records could safely be limited to those instances where a plan shows "reasonable cause" to believe that a specific employee is a participant. The court speculated that "[t]he Funds enjoy a number of protections against being call upon to dispense benefits to a participant on whose behalf no contributions or insufficient contributions were made," 698 F. 2d, at 813, that the plans thus did not need primarily to rely on its own monitoring to safeguard its interests, and that therefore "the possibility of liability . . . on the part of . . . the Funds [could] not justify the broad audit [the trustees] seek." *Ibid.*

A

The Court of Appeals first noted that employer contributions could effectively be policed by interested unions or by the Secretary of Labor, thus diminishing the trustee's interests in independently monitoring employer compliance. Moreover, in the court's view, a plan's reliance on union or government oversight of an employer's contributions would be more consistent with federal policies in the pension and labor fields than would be a plan's reliance on the sort of audit at issue here.

(1)

The notion that federal policy favors union enforcement of an employer's collectively-bargained obligations to a benefit plan, to the exclusion of enforcement by the plan's trustees, simply did not survive last Term's decision in *Schneider Moving & Storage Co.* v. *Robbins*, 466 U.S. ___ (1984). In *Schneider*, we held that a benefit plan could bring an independent action for judicial enforcement of an employer's trust obligations, and we in large part relied on the proposition that there was no federal policy favoring trustee dependence on a union's use of a grievance and arbitration system for such enforcement.[17]

Of greatest significance here is this Court's conclusion that compelling benefit plans to rely on unions would erode the protections ERISA assures to beneficiaries, for the diminishment of trustee responsibility that would result would not necessarily be made up for by the union. ERISA places strict duties on trustees with respect to the interests of beneficiaries, and unions' duties toward beneficiaries are of a quite different scope.

A trustee's duty extends to all participants and beneficiaries of a multiemployer plan, while a local union's duty is confined to current employees employed in the bargaining unit in which it has representational rights. The breadth of the trustee's duty may result in a very different view of the pecial situations that may exist in any single unit, and, as we recognized in *Schneider*, a union's arrangements with a particular employer might compromise the broader interests of the plan as a whole:

"These are multiemployer trust funds. Each of the participating unions and employers has an interest in the prompt collection of the proper contribution from each employer. Any diminution of the fund caused by the arbitration requirements of a particular employer's collective-bargaining agreement would have an adverse effect on the other participants." 466 U.S., at ___ (footnotes omitted).

See also *Lewis* v. *Benedict Coal Co.*, 361 U.S. 459, 469 (1960). See generally *Schneider*, *supra*, at ___, n. 22 (the union's duty "runs only to the members of its collective-bargaining unit, and is coextensive with its statutory authority to act as the exclusive representative for all the employees within the unit").[18]

Similarly, a local union's duties t bargaining-unit workers is a gener duty to act in the group's interests r garding the overall terms and cond tions of employment. The trustees duty, in contrast, is to provide specifi benefits to those who are entitled t them in accordance with the terms of plan. That the general nature of union's duty may result in less than ful protection to individual entitlement has been well recognized in our cases and we have accordingly refrained fro making enforcement of such entitle ments rest primarily on union action See *Barrentine* v. *Arkansas-Bes Freight System, Inc.*, 450 U.S. 72 (1981) (union goal of maximizing over all compensation for the bargaining uni as a whole may prevent it from effect ively policing employer's payment t each employee of statutory minimun wages). In *Schneider*, we recognize that in the context of ERISA primar reliance on unions would allow "wid discretion and would provide only lim ited protection," 466 U.S., at ___, n 22, to those participant and beneficiar rights that the statute was designed t ensure:

"A primary union objective is 't maximize overall compensation of it members.' Thus, it may sacrifice par ticular elements of the compensatio package 'if an alternative expenditur of resources would result in increase benefits for workers in the bargainin unit as a whole'." *Ibid.* (citatio omitted).

See also *NLRB* v. *Amax Coal Co.*, 45 U.S. 322, 336 (1981) ("The atmos phere in which employee benefit tru fund fiduciaries must operate, as mar dated by [29 U.S.C. §186(c)(5)] an ERISA, is wholly inconsistent wit th[e] process of compromise and ecc nomic pressure [that characterizes co lective bargaining]").

The rationale in *Schneider* and ou other cases in this area thus precludes holding that a benefit plan must prima ily rely on union monitoring of an em ployer's compliance with its tru

[17]The benefit plans involved in *Schneider* were the same plans that are petitioners here, and the trust agreements at issue in *Schneider* are also the same as those here.

[18]This potential conflict was also discussed in *Allied Chemical & Alkalai Workers* v. *Pittsburgh Plate Glass Co.*, 404 U.S. 157, 171-175 (1971), where we recognized that the interests of retirees may substantially conflict with the interests of active workers. Because of the potential conflicts, we held that retirees cannot be considered part of a collective-bargaining unit represented by union and that retirees' benefits are not within t mandatory subjects of union-employer collecti bargaining. Retirees, as beneficiaries of a pensi plan, clearly are within the class to whom trus ees owe a duty.

obligations.[19]

(2)

There are also compelling reasons why the Department of Labor's power to police employer compliance must be rejected as an alternative to audits by the plans themselves. Indeed, the structure of ERISA makes clear that Congress did not intend for government enforcement powers to lessen the responsibilities of plan fiduciaries.

First, the Department of Labor denies that it has the resources for policing the day-to-day operations of each multi-employer benefit plan in the Nation. The United States, as *amicus*, informs us that approximately 900,000 benefit plans file annual reports with the Secretary of Labor, and that between 11,000 and 12,000 of these are multiemployer plans. As the petitioners' situations illustrate, some multiemployer plans can be quite large. See n.1, *infra*. It is therefore not surprising that the United States argues that "[i]t is thus wholly unrealistic to suggest that centralizing all auditing authority in the Secretary would provide protection to benefit plan participants comparable to that afforded by trustee audits." Brief for United States as *Amicus Curiae* 20, n. 11.

Second, although ERISA grants the Secretary of Labor broad investigatory powers, see, *e.g.*, 29 U.S.C. §1134, neither the structure of the Act nor the legislative history show any congressional intent that plans should rely primarily on centralized federal monitoring of employer contribution requirements. Indeed, Congress expressly withheld from the Secretary the authority to initiate actions to enforce an employer's contribution obligations. See 29 U.S.C. §§1132(b)(2), 1145. In contrast, as we have noted, trustees were given the authority to sue to enforce an employer's obligations to a plan. §1132.

B

The Court of Appeals also challenged Central States' need for the audit because of the likelihood that covered employees would themselves come froward to assure that employers are making required contributions on their behalf. The court emphasized that participants could become aware of their status through the Act's reporting provisions. 698 F.2d, at 813 (citing 29 U.S.C. §1021). But although the reporting requirements are designed to assure that participants receive information about their status and rights, they do so by placing a reporting duty *on the plans*. Thus, to give participants initial notice of their status, the plans need to know the identities of participants. See nn. 14-15, *supra*, and accompanying text. That is, of course, precisely the information that Central States sought to verify in its requested audit.[20]

C

The Court of Appeals' remaining reason for questioning Central States' interest in the audit focused on the fact that a benefit plan would have an action against a delinquent employer should any benefit claims ever be made by a participant who had never been the subject of contributions. We reject the notion that the plan's ultimate ability to remedy an employer's breach of its obligations forecloses the plan from seeking to deter such breaches or to discover them early. Such a suggestion ignores the trustees' fiduciary duty to inform participants and beneficiaries of their rights, to gain immediate use of trust assets for the benefit of the trust, to avoid the time and expense of litigation, and to avoid unfunded liabilities that might eventually prove uncollectable as a result of insolvencies. For a plan passively to allow an employer to create such unfunded liabilities would jeopardize the participants' and beneficiaries' interests as well as those of all participating employers who properly comply with their obligations. See *Schneider*, 466 U.S., at ___, and n. 17.

The Court of Appeals argument obviously conflicts with one of the principal congressional concerns motivating the passage of the Act, that plans should assure themselves of adequate funding by promptly collecting employer contributions.[21] In ERISA, Con-

[19]In *Schneider* we not only concluded that compelling benefit plan reliance on union enforcement of trust obligations would have significant costs to the protections of ERISA, we also concluded that compelling such reliance would produce few benefits in terms of federal labor policies. For example, such policies as the presumption in favor of arbitrability derive in large part from the desire to promote alternatives to strikes, lockouts, and other exercises of economic power. But that goal has little relevance to the field of trust administration, where disputes between plans and practicipating employers do not normally have such results. 466 U.S., at ___, and n. 13.

[20]The Court of Appeals also questioned the importance of the audit's goal, speculating that the plan might simply be able to deny benefit claims of participants who had been notified of their status through the reporting requirement but had nevertheless taken no action to assure that their employers properly contributed on their behalf. 698 F. 2d, at 813. Obviously, this "estoppel argument" has the same flaw as the argument that a participant, once notified of his status, will come forward to identify himself: Before the plan can notify a participant of his status, it must have identified him, and such identification was the purpose of the requested audit.

In addition, however, the argument has other major problems. First, we note that the Labor Department has consistently taken the position that any pension plan document language denying benefits to a participant because of an employer's failure to make required contributions would violate ERISA and would thus be unenforceable. See n.7, *supra*. At a minimum, this means that Central States is reasonable in operating its audit program under the assumption that it would be liable for pension claims regardless of an employers failure to make required contributions. Second, the Court of Appeals did not contend that the reports Central States send to participants inform them of a burden of verifying their employer's contributions, or that the plan documents deny benefits on the basis of an employer's failure to make proper contributions. Thus, even if ERISA allowed a plan to operate in one of these manners, there has been no finding that the plans at issue here have done so.

[21]See Part III-C, *supra*.

[22]In the floor debate on the Multiemployer Pension Plan Amendments Act of 1980, Pub. L. 96-364, 94 Stat. 1208 [1980-2 C.B. 437], which amended ERISA to further protect the funding of multiemployer plans, one of the floor managers explained the problems some employers create for multiemployer plans by not fully and promptly complying with their contribution obligations:

"Failure of employers to make promised contributions in a timely fashion imposes a variety of costs on plans. While contributions remain unpaid, the plan loses the benefit of investment income that could have been earned if the past due amounts had been received and invested on time. Moreover, additional administrative costs are incurred in detecting and collecting delinquencies. Attorneys' fees and other legal costs arise in connection with collection efforts.

"These costs detract from the ability of plans to formulate or meet funding standards and adversely affect the financial health of plans. Participants and beneficiaries of plans as well as employers who honor their obligation to contribute in a timely fashion bear the heavier cost of delinquencies in the form of lower benefits and higher contribution rates. Moreover, . . . uncollected delinquencies can add to the unfunded liability for all employers." 126 Cong. Rec. 23039 (1980) (statement of Rep. Thompson).

gress sought to create a pension system in which "[a]ll current accruals of benefits based on current service . . . [would] be paid for immediately." H.R. Rep. No. 93-533, p. 14 (1973) [1974-3 C.B. 210, 223]. See generally 29 U.S.C. §1082. As the Reports accompanying the bills declared,

"The pension plan which offers full protection to its employees is one which is funded with accumulated assets which at least are equal to the accrued liabilities, and with a contribution rate sufficient to maintain that status at all times." *Id.*, at 7; S. Rep. No. 93-127, pp. 9-10 (1973) [1974-3 C.B. (Supp.) 9-10] (identical language).[22]

V

Given Congress' vision of the proper administration of employee benefit plans under ERISA, we have little difficulty holding that the audit requested by Central States is well within the authority of the trustees as outlined in the trust documents. But we should also specify what we do not hold. First, we do not hold that under ERISA a benefit plan's interests in fully identifying participants and beneficiaries *requires* that it conduct the sort of audit in question. This case involves only the trustees' *right* to conduct this particular kind of audit program, not their *duty* to do so. Second, we have no occasion to determine whether ERISA would independently confer on the trustees a right to perform the sort of audit demanded in this case in the face of trust documents that explicitly limit the audit powers of trustees. Cf. 29 U.S.C. §1104(a)(1)(D). Last, we have no occasion in this case to analyze what sort of factual showing would be necessary to a claim that a particular auditing program was being conducted in a manner that violated ERISA's fiduciary duties of loyalty or care. Although we do not question the proposition that the auditing powers of a benefit plan are limited to prudent actions furthering the legitimate purposes of the plan, there is no reason in ERISA or the plan documents of this case why the kind of audit requested here should, as a matter of law, be considered outside the scope of proper plan administration.[23]

The judgment of the Court of Appeals is accordingly reversed.

It is so ordered.

Section 414.—Definitions and Special Rules

Procedure for issuing determination letters covering the qualified plans of employers that are members of an affiliated service group under section 414(m) or employers that use leased employees under section 414(n). See Rev. Proc. 85-43, page 501.

Section 415.—Limitations on Benefits and Contributions Under Qualified Plans

26 CFR 1.415-1: General rules with respect to limitations on benefits and contributions under qualified plans.

Procedure for determining whether an employer that establishes or maintains a qualified plan is subject to the requirements of section 414(m) or 414(n) of the Code and satisfies the requirements for limitations on contributions and benefits under this section. See Rev. Proc. 85-43 page 501.

Section 416.—Special Rules for Top-Heavy Plans

Procedure for determining whether an employer that establishes or maintains a qualified plan is subject to the requirements of section 414(m) or 414(n) of the Code and satisfies the requirements for top-heavy plans under this section. See Rev. Proc. 85-43, page 501.

Section 417.—Definitions and Special Rules for Purposes of Minimum Survivor Annuity Requirements

26 CFR 1.417(e)-1T: Restrictions and valuations of distributions from plans subject to section 401(a)(11) (Temporary).

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[21]We note that in this case, Central States has agreed to various limits on its audit so as not to exceed what would be reasonably appropriate for the service of the audit's legitimate purposes. See n. 5, *supra*. Central States does not dispute that its right to demand access to employer records does not reach beyond what is appropriate for the proper administration of the plans, and of course, a court ordering an employer to comply with a particular audit demand could, upon a proper showing by the employer, limit the auditors accordingly. *Cf. Central States, Southeast and Southwest Areas Pension Fund* v. *Theut Products*, Civ. No. 82-71080 (ED Mich. Oct. 21, 1982) (Cohn, D.J.) (reprinted in App. to Pet. for Cert. A-96) (ordering an employer to comply with a benefit plan's audit request but allowing the employer to withhold specific information that was not relevant to the audit's purposes and allowing the employer to restrict the auditors' ability to copy or disclose information where the auditors' did not need to do so).

Effective dates, transitional rules restrictio on distributions, and other issues arising und the Retirement Equity Act of 1984. See T. 8038, page 130.

Subpart D.—Treatment of Welfare Benefit Funds

Section 419A.—Qualified Asset Account; Limitation on Additions to Account

26 CFR 1.419A-2T: Qualified asset account lim tation for collectively bargained fund (Temporary)

T.D. 8034

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1984

Treatment of Funded Welfare Benefit Plans

AGENCY: Internal Revenue Servic Treasury

ACTION: Temporary Regulations

SUMMARY: This document contai temporary regulations relating to we fare benefit funds maintained pursua to a collective bargaining agreemen This action is necessary because changes to the applicable law made the Tax Reform Act of 1984 [Pub. 98-369, 1985-3 C.B. (Vol. 1) 1]. T regulations provide guidance concer ing limits on contributions to and serves of a welfare benefit fund mai tained pursuant to a collecti bargaining agreement. The text of t temporary regulations set forth in th document also serves as the text of t proposed regulations cross-referenc * * * [on page 761, this Bulletin].

DATES: The temporary regulations a ply to contributions paid or accrued a ter December 31, 1985.

FOR FURTHER INFORMATIO CONTACT: John T. Ricotta of t Employee Plans and Exempt Organiz tions Division, Office of Chief Cou sel, Internal Revenue Service, 11 Constitution Ave., N.W., Washingto D.C. 20224 (Attention: CC:EE) (20 566-4396 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains temporary regulations relating to limits on contributions to and the reserves of welfare benefit funds maintained pursuant to a collective bargaining agreement under section 419A(f)(5) of the Internal Revenue Code of 1954 (Code), as added to the Code by section 511 of the Tax Reform Act of 1985 (26 U.S.C. §419A) [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1, 362]. The temporary regulations will remain in effect until superseded by final regulations on this subject.

FORMAT

These temporary regulations are presented in the form of questions and answers. Taxpayers may rely on them for guidance pending the issuance of final regulations. No inference should be drawn regarding issues not expressly raised, or by the inclusion or exclusion of certain questions.

Written comments are requested regarding current funding practices and requirements of collectively bargained welfare benefit funds, and the need for special rules in selected situations, such as for collectively bargained funds maintained by employers in declining industries. In addition, comments by employers in declining industries. In addition, comments are requested regarding appropriate rules for allocating the assets of a welfare benefit fund between employees covered by a collective bargaining agreement and other employees.

NONAPPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this regulation is not subject to review under Executive Order 12291.

REGULATORY FLEXIBILITY ACT

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for temporary regulations. Accordingly, the Regulatory Flexibility Act does not apply and a Regulatory Impact Analysis is not required for this rule.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph 1. These amendments to Part 1 are issued under the authority contained in 26 U.S.C. §7805. The authority citation for Part 1 is unchanged.

Paragraph 2. A new §1.419A-2T is added immediately following §1.416-1 to read as follows:

§1.419A-2T Qualified asset account limitation for collectively bargained funds. (Temporary)

Q-1: What account limits apply to welfare benefit funds that are maintained pursuant to a collective bargaining agreement.

A-1: Contributions to a welfare benefit fund maintained pursuant to one or more collective bargaining agreements and the reserves of such a fund generally are subject to the rules of sections 419, 419A, and 512. However, neither contributions to nor reserves of such a collectively bargained welfare benefit fund shall be treated as exceeding the otherwise applicable limits of section 419(b), 419A(b), or 512(a)(3)(E) until the earlier of: (i) the date on which the last of the collective bargaining agreements relating to the fund in effect on, or ratified on or before, the date of issuance of final regulations concerning such limits for collectively bargained welfare benefit funds terminates (determined without regard to any extension thereof agreed to after the date of issuance of such final regulations), or (ii) the date 3 years after the issuance of such final regulations.

Q-2: What is a welfare benefit fund maintained pursuant to a collective bargaining agreement for purposes of Q&A-1?

A-2: (1) For purposes of Q&A-1, a collectively bargained welfare benefit fund is a welfare benefit fund that is maintained pursuant to an agreement which the Secretary of Labor determines to be a collective bargaining agreement and which meets the requirements of the Secretary of Treasury as set forth in paragraph 2 below.

(2) Notwithstanding a determination by the Secretary of Labor that an agreement is a collective bargaining agreement, a welfare benefit fund is considered to be maintained pursuant to a collective bargaining agreement only if the benefits provided through the fund were the subject of arms-length negotiations between employee representatives and one or more employers, and if such agreement between employee representatives and one or more employers satisfies section 7701(a)(46) of the Code. Moreover, the circumstances surrounding a collective bargaining agreement must evidence good faith bargaining between adverse parties over the welfare benefits to be provided through the fund. Finally, a welfare benefit fund is not considered to be maintained pursuant to a collective bargaining agreement unless at least 50 percent of the employees eligible to receive benefits under the fund are covered by the collective bargaining agreement.

(3) In the case of a collectively bargained welfare benefit fund, only the portion of the fund (as determined under allocation rules to be provided by the Commissioner) attributable to employees covered by a collective bargaining agreement, and from which benefits for such employees are provided, is considered to be maintained pursuant to a collective bargaining agreement.

(4) Notwithstanding the preceding paragraphs and pending the issuance of regulations setting account limits for collectively bargained welfare benefit funds, a welfare benefit fund will not be treated as a collectively bargained welfare benefit fund for purposes of Q&A-1 if and when, after July 1, 1985, the number of employees who are not covered by a collective bargaining agreement and are eligible to receive benefits under the fund increases by reason of an amendment, merger, or other action of the employer or the fund. In addition, pending the issuance of such regulations, for purposes of applying the 50 percent test of paragraph (2) to a welfare benefit fund that is not in existence on July 1, 1985, "90 percent" shall be substituted for "50 percent".

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

M. EDDIE HEIRONIMUS,
Acting Commissioner of Internal Revenue.

Approved June 28, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 1, 1985, 8:45 a.m., and published in the issue of the Federal Register for July 3, 1985, 50 F.R. 27427).

Subchapter E.—Accounting Periods and Methods of Accounting
Part I.—Accounting Periods

Section 442.—Change of Annual Accounting Period

26 CFR 1.442-1: Change of annual accounting period.

Procedures for change in annual accounting period by exempt organizations. See Rev. Proc. 85-58, page 740.

Part II.—Methods of Accounting
Subpart A.—Methods of Accounting in General

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446-1: General rule for methods of accounting.

Procedures are provided for taxpayers using the cash receipts and disbursements method of accounting to obtain expeditious consent to change their overall method of accounting to the accrual method. See Rev. Proc. 85-36, page 434, and Rev. Proc. 85-37, page 438.

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26 CFR 1.446-1: General rule for methods of accounting.

Procedures are provided for taxpayers that use the LIFO inventory method of accounting and that issued nonconforming financial statements under section 472(g) of the Code to automatically discontinue the use of the LIFO inventory method for their first tax year beginning on or after July 18, 1984. See Rev. Proc. 85-54, page 734.

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26 CFR 1.446-1: General rule for methods of accounting.

Whether a partnership must accelerate the portion of an unamortized section 481(a) adjustment applicable to one of its trades or businesses after that trade or business is incorporated. See Rev. Rul. 85-134, page 160.

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26 CFR 1.446-1(e): Requirement respecting the adoption or change of accounting method.
(Also Sections 166, 381, 585, 593; 1.166-4, 1.381(c)(4)-1, 1.585-1, 1.593-1.)

Accounting methods; change; bad debt reserves; section 481 adjustment. The integration under section 381(c)(4) of the Code of a distressed thrift institution's bad debt reserve computed under section 593 into an acquiring commercial bank's bad debt reserve computed under section 585 results in a change in method of accounting. Therefore, an adjustment under section 481(a) is required. Rev. Ruls. 75-445 and 79-123 distinguished.

Rev. Rul. 85-171

ISSUE

Does the integration under section 381(c)(4) of the Internal Revenue Code of a distressed thrift institution's bad debt reserve, computed under section 593, into an acquiring commercial bank's bad debt reserve, computed under section 585, result in a change in method of accounting, thereby necessitating a section 481(a) adjustment?

FACTS

BK is a commercial bank to which section 585 of the Code applies. *BK* maintains a bad debt reserve for its mortgage and other loans in accordance with section 585, making annual additions to the reserve as permitted by that section. *T* is a thrift institution to which section 593 applies. *T* maintains a bad debt reserve for its mortgage and other loans in accordance with section 593, making annual additions to the reserve as permitted by that section. On January 2, 1984, *T* merged into *BK*. The merger of *T* into *BK* qualified as a reorganization under section 368(a)(1)(G) and (a)(3)(D)(ii). After the reorganization, *BK*'s original business and that acquired from *T* were operated by *BK* as an integrated commercial bank business.

LAW AND ANALYSIS

Section 446(a) of the Code provides the general rule for methods of accounting. Section 1.446-1(a)(1) of the Income Tax Regulations states that the term "method of accounting" includes not only the over-all method of accounting of the taxpayer but also the accounting treatment of any item. Section 1.446-1(e)(2)(ii)*(a)* states that a change in the method of accounting includes a change in the overall plan of accounting for gross income or deductions or a change in the treatment of any material item used in such overall plan. Section 1.446-1(e)(2)(ii)*(a)* provides further that a "material item" is any item that involves the proper time for the inclusion of the item in income or the taking of a deduction. Section 1.446-1(e)(2)(ii)*(b)* states that a change in the method of accounting does not include an adjustment with respect to the addition to a reserve for bad debts.

Section 166(a) of the Code allows a deduction for any debt that becomes worthless during the taxable year. Section 166(c) states that in lieu of any deduction under subsection (a), there shall be allowed (in the discretion of the Secretary) a deduction for a reasonable addition to a reserve for bad debts. Section 166(g)(3) provides a cross reference to section 593 with respect to special rules for bad debt reserves of certain mutual savings banks, domestic building and loan associations, and cooperative banks, and section 166(g)(4) provides a cross reference to section 585 with respect to special rules for bad debt reserves of banks.

Section 585(b)(1) of the Code provides that, for purposes of section 166(c), the reasonable annual addition to the reserve for bad debts of any financial institution to which such section applies is computed by either the percentage method provided by section 585(b)(2) or the experience method provided by section 585(b)(3). The percentage method is based on "eligible loans" (as defined in the Code and regulations); the experience method is based on "loans outstanding" as so defined. For purposes of computing the reserve addition, there is no maximum reserve balance under the experience method; however, under the percentage method the maximum reserve is 1.2 percent of eligible loans in taxable years beginning after 1975 but before 1982; 1 percent of eligible loans for 1982; and .6 percent thereafter through 1987 (when use of the percentage method ceases).

Section 593(b) of the Code provides that, for purposes of section 166(c), the reasonable annual addition to the bad debt reserve shall be an amount equal to the sum of a reserve for nonqualifying loans plus a reserve for

qualifying real property loans. Section 593(b)(1)(A) provides that the allowable annual addition to the bad debt reserve for nonqualifying loans (loans other than qualifying real property loans) is determined under the experience method for banks provided by section 585(b)(3). The addition for qualifying real property loans, as defined in section 593(d), may be computed under either the experience method for banks provided by section 585(b)(3), the percentage method for banks provided by section 585(b)(2) as adjusted by section 593(b)(3), or the percentage of taxable income method for thrift institutions provided by section 593(b)(2). While section 593(b)(2)(A) provides that the applicable percentage for the percentage of taxable income method for 1979 and later years is 40 percent, section 593(b)(2)(D) provides that the maximum reserve balance under such method is 6 percent of qualifying real property loans outstanding at the close of the taxable year.

Section 381(c)(4) of the Code provides that the acquiring corporation in a reorganization to which section 368(a)(1) applies shall use the method of accounting used by the transferor corporation unless several transferors or the acquiring corporation and a transferor used different methods. In that event, the method or combination of methods shall be prescribed by regulations. Section 1.381(c)(4)-1(b)(2) of the regulations provides that if, after a reorganization, the businesses of the parties to the transaction are operated as separate and distinct businesses, then the method of accounting employed by each business shall be continued. But if, after the reorganization, any of the businesses is not operated as a separate and distinct business, to the extent that different methods of accounting were employed on the date of the reorganization, the principal method of accounting employed shall be used, provided it can be used and clearly reflects income. See section 1.381(c)(4)-1(b)(3) and (c).

Section 1.381(c)(4)-1(a)(1)(ii) of the regulations states that the acquiring corporation shall take into its accounts the dollar balances of those accounts of the transferor corporation that represent reserves in respect of which the transferor has taken a deduction. However, this same paragraph of the regulations also states that the amount of the adjustments necessary to reflect a change of accounting method, the manner in which they are to be taken into account, and the tax attributable thereto shall be determined under section 481 of the Code.

In the present situation, prior to the reorganization *BK* maintained a bad debt reserve in accordance with section 585 of the Code and *T* maintained a bad debt reserve in accordance with section 593. After the reorganization, *BK* continued to operate its business and that acquired from *T* as an integrated commercial bank business. Since *BK* is not qualified to conduct business as a thrift institution, *BK* is not permitted to use the bad debt reserve method provided by section 593. Hence, for the mortgage and other loans acquired from *T*, *BK* will be required, because of the change of business, to shift from computing bad debt reserves and additions under section 593 of the Code to computing them under section 585.

Section 1.381(c)(4)-1(c)(1) of the regulations provides that when an acquiring corporation must use a different method of accounting for an acquired business than its transferor did, the adjustments necessary to reflect such change and any resulting increase or decrease in tax are determined as if the transferor had initiated a change of accounting method, and any consequent increase or decrease in tax is taken into account by the acquiring corporation.

Rev. Rul. 75-445, 1975-2 C.B. 74, concludes that changing from the percentage method to the experience method within section 585 of the Code is not a change in method of accounting, but that the reserve method described in section 585 is a method of accounting. Rev. Rul. 79-123, 1979-1 C.B. 215, concludes that changing from the percentage of loans method to either the percentage of taxable income method or the experience method within section 593 of the Code are not changes in methods of accounting. However, the reserve method described in section 593 is a method of accounting.

Section 1.446-1(e)(2)(ii)*(a)* of the regulations provides that a change in the method of accounting includes a change in the overall plan of accounting for gross income or deductions or a change in the treatment of any material item used in such overall plan. This same regulation defines a "material item" as any item that involves the proper time for the inclusion of the item in income or the taking of a deduction.

A change from the method of estimating a reasonable addition to a bad debt reserve under section 593 of the Code (thrift) to the method of estimating that addition under section 585 (bank) is a change in the treatment of a material item and therefore is a change in method of accounting because it affects the proper time of taking a deduction. *See* section 1.446-1(e)(2)(ii) of the regulations. It affects the proper time of taking a deduction because it determines the amount of the deduction, both in the current year and in future years, and the amounts deductible under the two methods are not the same.

Section 1.446-1(e)(2)(ii)*(b)* of the regulations, which provides that a change of accounting method does not include an adjustment with respect to the addition to a reserve for bad debts, is not applicable in the present situation. That statement is made in the context of changes that do not alter the method of accounting itself (such as a change in the useful life of a depreciable asset) and relates only to an adjustment in computing the annual addition for bad debts that corrects differences between prior estimates of bad debt experience and actual bad debt experience. Such corrections have traditionally been treated as self-adjusting in the current year. *See* section 1.166-4(b)(2).

HOLDING

The integration under section 381(c)(4) of the Code of a distressed thrift institution's bad debt reserve computed under section 593 of the Code into an acquiring commercial bank's bad debt reserve computed under section 585 results in a change in method of accounting, thereby necessitating a section 481(a) adjustment.

EFFECT ON
OTHER DOCUMENTS

Rev. Rul. 75-445 and Rev. Rul. 79-123 are distinguished.

Subpart B.—Taxable Year for Which Items of Gross Income included

Section 453A.—Installment Method for Dealers in Personal Property

26 CFR 1.453-1: Installment method of reporting income.

Whether parent corporation that is a dealer in personal property may treat the extension of credit by its subsidiary, a national bank, to the parent corporation's customers as equivalent to the parent corporation selling on the installment basis to its customers and then selling the installment obligations in a deferred intercompany transaction to its subsidiary. See Rev. Rul. 85-133, page 192.

Subpart C.—Taxable Year for Which Deductions Taken

Section 465.—Deductions Limited to Amount at Risk

(Also Section 616; 26 CFR 1.616-1.)

Deductions; losses; amount at risk; mining development. An investor is not at risk for a note that may be satisfied by transferring to the creditor property derived from the mining activity without any obligation that the investor pay the difference if the value of the property is less than the amount due on the note.

Rev. Rul. 85-113

ISSUE

Is an investor at risk within the meaning of section 465 of the Internal Revenue Code for amounts borrowed under the circumstances described below?

FACTS

In 1983 *X* corporation offered to sell to investors the rights to mine units consisting of a specific number of cubic yards of ore which purportedly contained precious metals. The cost of the mining rights for each unit was 7*x* dollars plus 35 percent of the precious metals recovered from the ore.

Each investor could mine the investor's own unit of ore or hire *Z* to perform these services. *Z* offered to develop each ore site for a cost of 60*x* dollars and to mine and process the ore in return for 20 percent of each of the precious metals recovered from the ore.

In order to help investors finance the cost of the mining development, *X* arranged with its affiliate, *Y*, to lend each investor 52*x* dollars for each unit acquired. Each note is payable in 5 years with 14 percent interest. The note purports to make the investors personally liable for the payment of principal and interest on the note. Each investor, however, has the option to assign to *Y* a right to 22 percent of the precious metals extracted from the investor's unit in full payment of the note.

In the promotional materials, *X* represented that the units of ore contained commercially marketable quantities of various precious metals. During 1983 *A* paid *X* 7*x* dollars in partial consideration for the purchase of mining rights to one unit of ore. *A* borrowed 52*x* dollars from *Y* and used those funds together with 8*x* dollars of A's own money to pay *Z* for the mining development expenses. During 1983 *Z* notified *A* that the mining development on *A*'s site had been completed. *A* did not have any income from the mining activity during 1983. On *A*'s federal income tax return for 1983, *A* claimed a 60*x* dollar deduction for mining development expenditures under section 616(a) of the Code.

LAW AND ANALYSIS

Section 616(a) of the Code provides that except where the taxpayer elects otherwise as provided in section 616(b), there shall be allowed as a deduction in computing taxable income all expenditures paid or incurred during the taxable year for the development of a mine or other natural deposit (other than an oil or gas well) if paid or incurred after the existence of ores or minerals in commercially marketable quantities has been disclosed.

Section 465(a)(1) of the Code provides that in the case of an individual engaged in an activity to which the section applies, any loss from the activity for the taxable year shall be allowed only to the extent of the aggregate amount with respect to which the taxpayer is at risk (within the meaning of subsection (b)) for the activity at the close of the taxable year.

Section 465(b)(1) of the Code provides that the amounts for which a taxpayer is considered at risk for an activity include the amount of money and the adjusted basis of other property contributed by the taxpayer to the activity, and amounts borrowed with respect to the activity (as determined under section 465(b)(2)). Section 465(b)(2) provides that a taxpayer shall be considered at risk with respect to amounts borrowed for use in an activity to the extent that the taxpayer is personally liable for the repayment of the amounts or has pledged property, other than property used in the activity, as security for the borrowed amount (to the extent of the net fair market value of the taxpayer's interest in the property).

In the present situation *A* claims to be personally liable on the note to *Y*. *A*, however, has the option of completely satisfying all obligations on the note by transferring to *Y* a right to 22 percent of the precious metals extracted from *A*'s unit of ore. If the value of this right when the note becomes due is less than the balance due on the note, *A* will have no obligation to pay *Y* the difference. Under these circumstances, the note in reality is a nonrecourse obligation secured solely by a right to property derived from the activity. Thus, *A* is not at risk with respect to the 52*x* dollars borrowed from *Y*.

HOLDING

A is not at risk within the meaning of section 465 of the Code, for the 52*x* dollars borrowed from *Y*. *A*'s at risk amount at the end of 1983 is 15*x* dollars, representing the 7*x* dollars paid to *X* for the mining rights and the 8*x* dollars of *A*'s funds paid to *Z* for the mining development.

Section 467.—Certain Payments for the Use of Property or Services

Federal short-term, mid-term and long-term rates determined under the alternate method as provided by section 1.1274-6T of the Temporary Income Tax Regulations are set forth for the month of July 1985. See Rev. Rul. 85-91, page 187.

Federal short-term, mid-term and long-term rates determined under the alternate method as provided by section 1.1274-6T of the Temporary Income Tax Regulations are set forth for the month of August 1985. See Rev. Rul. 85-117, page 187.

Federal short-term, mid-term and long-term rates determined under the alternate method as provided by section 1.1274-6T of the Temporary Income Tax Regulations are set forth forth for the month of September 1985. See Rev. Rul. 85-137, page 187.

al short-term, mid-term and long-term
termined under the alternate method as
by section 1.1274-6T of the Temporary
Tax Regulations are set forth forth for the
f October 1985. See Rev. Rul. 85-154,
3.

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are the applicable federal rates to be used
poses of section 467? See Rev. Rul.
page 186.

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al short-term, mid-term and long-term
termined under the alternate method as
by section 1.1274-6T of the Temporary
Tax Regulations are set forth for the
f November 1985. See Rev. Rul. 85-181,
3.

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al short-term, mid-term and long-term
termined under the alternate method as
by section 1.1274-6T of the Temporary
Tax Regulations are set forth for the
f December 1985. See Rev. Rul. 85-190,
6.

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n 468.—Special Rules for and Solid Waste Reclamation osing Costs

are the applicable federal rates to be used
poses of section 468? See Rev. Rul.
page 186.

D.—Inventories

n 471.—General Rule for ories

1.471-1: Need for inventories.

dures are provided for taxpayers using
receipts and disbursements method of
ing to obtain expeditious consent to
heir overall method of accounting to the
nethod. See Rev. Proc. 85-36, page 434.

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n 472.—Last-in, First-Out ories

1.472: Requirements incident to adoption use of LIFO inventory method.

ntories; LIFO; goods obtained in urchase immediately after incor-n. A newly formed corporation elects the LIFO inventory d may not treat goods obtained ulk purchase immediately after corporation as opening inven- Rev. Rul. 70-564 guished.

ul. 85-172

v a newly-formed corporation oods obtained in a bulk purchase diately after its incorporation as ng inventory if it elects the last-in, first-out (LIFO) method of valuing inventory?

FACTS

Corporation *X* was incorporated on June 27, 1982, and elected to use the calendar year as its annual accounting period. Immediately after its incorporation, *X* made a bulk purchase of inventory from an unrelated corporation. *X* elected to use the LIFO method to value all its inventory beginning with its first year of operation. In addition, *X* elected to value incremental increases by reference to most recent purchases.

LAW AND ANALYSIS

Section 472(a) of the Internal Revenue Code authorizes a taxpayer to use the LIFO method of inventory valuation described in section 472(b).

Section 472(b) describes the LIFO method, under which, in inventorying goods the taxpayer shall: (1) Treat those goods remaining on hand at the close of the taxable year as being: First, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof; and second, those acquired in the taxable year; (2) Inventory them at cost; and (3) Treat those included in the opening inventory of the taxable year in which such method is first used as having been acquired at the same time and determine their cost by the average cost method.

Section 1.472-2 of the Income Tax Regulations conditions the adoption and use of LIFO on certain requirements. Under section 1.472-2(b) the inventory must be taken at cost regardless of market value. Section 1.472-2(c) provides that goods of the specified type included in the opening inventory of the taxable year for which the method is first used shall be considered as having been acquired at the same time and at a unit cost equal to the actual cost of the aggregate divided by the number of units on hand. The actual cost of the aggregate shall be determined pursuant to the inventory method employed by the taxpayer under the regulations applicable to the prior taxable year, with the exception that restoration shall be made with respect to any writedown to market values resulting from the pricing of former inventories. Section 1.472-2(d) provides that goods of the specified type on hand as of the close of the taxable year, in excess of what were on hand as of the beginning of the taxable year, shall be included in the closing inventory, regardless of identification with specific invoices and regardless of specific cost accounting records, at costs dependent upon the character of the tax in which the taxpayer is engaged.

Section 1.472-2(d)(1)(i) of the regulations lists the methods taxpayers may use to determine the value of an incremental increase. An incremental increase occurs when the goods on hand at the close of a tax year exceed the opening inventory. An incremental increase may be valued by reference to (a) most recent purchases, (b) order of acquisition, (c) average cost, or (d) any other method which, in the opinion of the Commissioner, clearly reflects income. If corporation *X* had elected to value incremental increases by reference to the "order of acquisition" instead of the "most recent purchases," the cost of the bulk purchase would be the first cost included in any increment. However, since corporation *X* elected to value incremental increases by reference to the "most recent purchases," the cost of the bulk purchase will be the last cost included in any increment. Two examples of the differences that result from the application of the various methods of valuing in incremental increase are presented in section 1.472-2(d)(1)(i) of the regulations.

Rev. Rul. 70-564, 1970-2 C.B. 109, states that a newly-formed corporation receiving LIFO inventory in a transaction to which section 351 applies, shall treat such inventory as its opening inventory for LIFO purposes, and shall determine its cost using the average cost method pursuant to section 472(b)(3). Rev. Rul. 70-564 states that because the taxpayer received the inventory in a tax free transfer under section 351, section 362(a) is applicable. Under section 362(a)(1), the inventories acquired by the newly-formed corporation retain the same basis with that corporation that they had in the hands of the transferor corporation. The effect of Rev. Rul. 70-564 is to place the inventory transferred under section 351 to a newly-formed corporation in the category of opening inventory, rather than

categorizing it as an acquisition of inventory during the year.

Section 472(a)(1) of the Code and section 1.472-1(a) of the regulations distinguish between those goods in opening inventory and those acquired in the taxable year, stating that for purposes of the LIFO computation, inventory remaining on hand at the close of the taxable year shall be treated as being: first, those included in the opening inventory of the taxable year (in the order of acqui ition) to the extent thereof; and second, those acquired in the taxable year. This language is essentially the same as the language of the Committee on Finance in considering the 1939 amendments to section 472 (then section 22(d)). S. Rep. No. 648, 76th Cong., 1st Sess. 6-7 (1949), 1939-2 C.B. 524, 528. The report of the Committee on Finance further stated, parenthetically, their understanding that opening inventory constitutes the closing inventory of the previous year. Thus, as in the instant case, when there is no closing inventory in the previous year there is no opening inventory for the next year.

For purposes of LIFO computations all purchases of inventory in a taxable year are treated as acquisitions in the taxable year, and opening inventory constitutes the closing inventory of the previous year. Exceptions are provided, as in Rev. Rul. 70-564, where there are tax-free transfers instead of outright purchases.

In this case, *X* acquired inventory by a bulk purchase from an unrelated corporation rather than by a section 351 tax free transfer. This purchase is more than a mere change in the form of ownership and *X* does not retain the transferor's basis in the inventory. Thus, the rationale for having the ending inventory of the transferor treated as the opening inventory of the transferee in Rev. Rul. 70-564 is not present here.

HOLDING

A newly-formed corporation may not treat goods obtained in a bulk purchase immediately after its incorporation as opening inventory when it elects the LIFO method to value inventory, but must treat them as goods acquired in the taxable year.

EFFECT ON
OTHER DOCUMENTS

Rev. Rul. 70-564 is distinguished.

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26 CFR 1.472-1: Last-in, first-out inventories

LIFO; price indexes; department stores. The March 1985 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, March 31, 1985.

Rev. Rul. 85-108

The following price indexes for March 1985 were issued by the Bureau of Labor Statistics on April 25, 1985, for use by department stores, and are accepted by the Internal Revenue Service, under section 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 72-21, 1972-1 C.B. 745, for appropriate application of inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, March 31, 1985.

Indexes are prepared on a national basis for the store total, for 20 major groups of departments, and for two special combinations—soft and durable goods. The store total index covers all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, paints, and wallpaper, as well as contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100)

		March 1984	March 1985	Percentage Change from March 1984 to March 1985[1]
I.	Piece Goods	392.5	392.6	0.0
II.	Domestics and Draperies	541.6	547.8	1.1
III.	Women's and Children's Shoes	544.8	551.9	1.3
IV.	Men's Shoes	690.7	711.9	3.1
V.	Infants' Wear	479.3	498.5	4.0
VI.	Women's Underwear	418.6	430.3	2.8
VII.	Women's and Girls' Hosiery	232.1	236.2	1.8
VIII.	Women's and Girls' Accessories	429.8	440.6	2.5
IX.	Women's Outerwear and Girls' Wear	330.6	351.4	6.3
X.	Men's Clothing	452.9	465.9	2.9
XI.	Men's Furnishings	460.2	477.4	3.7
XII.	Boys' Clothing and Furnishings	424.5	432.4	1.9
XIII.	Jewelry	701.5	692.3	−1.3
XIV.	Notions	470.5	485.2	3.1
XV.	Toilet Articles and Drugs	609.1	631.7	3.7
XVI.	Furniture and Bedding	513.8	530.9	3.3

XVII.	Floor Coverings	449.7	465.1	3.4
XVIII.	Housewares	727.5	717.5	−1.4
XIX.	Major Appliances	241.1	242.8	0.7
XX.	Radio and Television	112.5	107.3	−4.6
	Groups I–XV: Soft Goods	463.8	478.1	3.1
	Groups XVI–XX: Durable Goods	443.7	445.8	0.5
	Store Total	457.9	469.0	2.4

[1]Absence of a minus sign before percentage change in this column signifies price increase

26 CFR 1.472-1: Last-in, first-out inventories

LIFO; price indexes; department stores. The April 1985 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, April 30, 1985.

Rev. Rul. 85-128

The following price indexes for April 1985 were issued by the Bureau of Labor Statistics on May 23, 1985, for use by department stores, and are accepted by the Internal Revenue Service, under section 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 72-21, 1972-1 C.B. 745, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, April 30, 1985.

Indexes are prepared on a national basis for the store total, for 20 major groups of departments, and for two special combinations—soft and durable goods. The store total index covers all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, paints , and wallpaper, as well as contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100)

		April 1984	April 1985	Percentage Change from April 1984 to April 1985[1]
I.	Piece Goods	400.2	391.3	−2.2
II.	Domestics and Draperies	536.5	541.5	0.9
III.	Women's and Children's Shoes	584.4	557.8	1.7
IV.	Men's Shoes	693.8	711.3	2.5
V.	Infants' Wear	479.3	487.3	1.7
VI.	Women's Underwear	417.5	435.6	4.3
VII.	Women's and Girls' Hosiery	231.8	234.5	1.2
VIII.	Women's and Girls' Accessories	433.7	436.8	0.7
IX.	Women's Outerwear and Girls' Wear	329.5	350.1	6.3
X.	Men's Clothing	459.9	473.4	2.9
XI.	Men's Furnishings	460.9	479.3	4.0
XII.	Boys' Clothing and Furnishings	421.8	436.2	3.4
XIII.	Jewelry	699.0	691.1	−1.1
XIV.	Notions	475.8	486.1	2.2
XV.	Toilet Articles and Drugs	614.9	633.2	3.0
XVI.	Furniture and Bedding	525.0	544.3	3.7
XVII.	Floor Coverings	449.8	460.4	2.4
XVIII.	Housewares	735.3	717.3	−2.4
XIX.	Major Appliances	242.1	244.4	0.9
XX.	Radio and Television	112.0	106.5	−4.9
	Groups I–XV: Soft Goods	464.2	477.8	2.9
	Groups XVI–XX: Durable Goods	448.8	449.1	0.1
	Store Total	459.6	469.7	2.2

[1]Absence of a minus sign before percentage change in this column signifies price increase.

26 CFR 1.472-1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The May 1985 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, May 31, 1985.

Rev. Rul. 85-157

The following price indexes for May 1985 were issued by the Bureau of Labor Statistics on June 24, 1985, for use by department shores, and are accepted by the Internal Revenue Service, under section 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 72-21, 1972-1 C.B. 745, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, May 31, 1985.

Indexes are prepared on a basis for the store total, for groups of departments, and special combinations—soft and goods. The store total index c departments, including some separately, with the followin tions: candy, foods, liquor, paints, and wallpaper, as wel tract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100)

		May 1984	May 1985	Percentage Change from May 1984 to May 1985[1]
I.	Piece Goods	401.4	393.4	–2.0
II.	Domestics and Draperies	543.3	552.6	1.7
III.	Women's and Children's Shoes	551.6	554.1	0.5
IV.	Men's Shoes	702.6	713.8	1.6
V.	Infants' Wear	470.1	492.8	4.8
VI.	Women's Underwear	419.2	438.2	4.5
VII.	Women's and Girls' Hosiery	233.9	235.2	0.6
VIII.	Women's and Girls' Accessories	433.8	436.0	0.5
IX.	Women's Outerwear and Girls' Wear	330.0	345.7	4.8
X.	Men's Clothing	460.5	472.5	2.6
XI.	Men's Furnishings	464.0	480.5	3.6
XII.	Boys' Clothing and Furnishings	420.5	438.0	4.2
XIII.	Jewelry	696.4	684.8	–1.7
XIV.	Notions	479.4	483.8	0.9
XV.	Toilet Articles and Drugs	613.8	635.4	3.5
XVI.	Furniture and Bedding	526.8	534.4	1.4
XVII.	Floor Coverings	449.8	462.8	2.9
XVIII.	Housewares	722.5	716.9	–0.8
XIX.	Major Appliances	243.7	246.6	1.2
XX.	Radio and Television	111.5	105.2	–5.6
	Groups I-XV: Soft Goods	465.4	478.3	2.8
	Groups XVI-XX: Durable Goods	446.2	446.2	0.0
	Store Total	459.6	569.2	2.1

[1]Absence of a minus sign before percentage change in this column signifies price increase

26 CFR 1.472-1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The June 1985 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, June 30, 1985.

Rev. Rul. 85-165

The following price indexes for June 1985 were issued by the Bureau of Labor Statistics on July 25, 1985, for use by department stores, and are accepted by the Internal Revenue Service, under section 1.472-1(k) of the Inco Regulations and Rev. Proc. 1972-1 C.B. 745, for appropria cation to inventories of dep stores employing the retail in and last-in, first-out inventory for tax years ended on, or wi ence to, June 30, 1985.

Indexes are prepared on a national basis for the store total, for 20 major groups of departments, and for two special combinations—soft and durable goods. The store total index covers all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, paints, and wallpaper, as well as contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100)

		June 1984	June 1985	Percentage Change from June 1984 to June 1985[1]
I.	Piece Goods	401.0	400.7	−0.1
II.	Domestics and Draperies	536.9	542.9	1.1
III.	Women's and Children's Shoes	547.6	553.7	1.1
IV.	Men's Shoes	700.5	716.8	2.3
V.	Infants' Wear	462.6	498.2	7.7
VI.	Women's Underwear	418.2	431.3	3.1
VII.	Women's and Girls' Hosiery	232.8	236.0	1.4
VIII.	Women's and Girls' Accessories	434.2	435.4	0.3
IX.	Women's Outerwear and Girls' Wear	322.3	339.8	5.4
X.	Men's Clothing	455.7	465.1	2.1
XI.	Men's Furnishings	462.6	476.7	3.0
XII.	Boys' Clothing and Furnishings	419.8	436.8	4.0
XIII.	Jewelry	701.7	682.9	−2.7
XIV.	Notions	481.5	488.9	1.5
XV.	Toilet Articles and Drugs	617.5	636.4	3.1
XVI.	Furniture and Bedding	527.0	535.5	1.6
XVII.	Floor Coverings	450.2	466.6	3.6
XVIII.	Housewares	726.3	720.3	−0.8
XIX.	Major Appliances	242.0	244.7	1.1
XX.	Radio and Television	110.3	104.0	−5.7
	Groups I–XV: Soft Goods	461.8	474.4	2.7
	Groups XVI–XX: Durable Goods	446.5	446.9	0.1
	Store Total	457.3	466.9	2.1

[1]Absence of a minus sign before percentage change in this column signifies price increase.

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26 CFR 1.472-1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The July 1985 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, July 31, 1985.

Rev. Rul. 85-174

The following price indexes for July 1985 were issued by the Bureau of Labor Statistics on August 26, 1985, for use by department stores, and are accepted by the Internal Revenue Service, under section 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 72-21, 1972-1 C.B. 745, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, July 31, 1985.

Indexes are prepared on a national basis for the store total, for 20 major groups of departments, and for two special combinations—soft and durable goods. The store total index covers all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, paints, and wallpaper, as well as contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100)

		July 1984	July 1985	Percentage Change fro July 1984 t July 1985[1]
I.	Piece Goods	398.4	391.8	−1.7
II.	Domestics and Draperies	528.7	530.6	0.4
III.	Women's and Children's Shoes	538.0	544.8	1.3
IV.	Men's Shoes	702.7	711.8	1.3
V.	Infants' Wear	463.7	491.1	5.9
VI.	Women's Underwear	418.6	435.3	4.0
VII.	Women's and Girls' Hosiery	231.8	233.4	0.7
VIII.	Women's and Girls' Accessories	430.8	430.0	−0.2
IX.	Women's Outerwear and Girls' Wear	313.3	327.5	4.5
X.	Men's Clothing	456.1	462.0	1.3
Xi.	Men's Furnishings	454.5	474.6	4.4
XII.	Boys' Clothing and Furnishings	424.1	432.5	2.0
XIII.	Jewelry	703.4	685.0	−2.6
XIV.	Notions	481.7	488.5	1.4
XV.	Toilet Articles and Drugs	621.3	638.6	2.8
XVI.	Furniture and Bedding	522.5	530.0	1.4
XVII.	Floor Coverings	453.1	461.9	1.9
XVIII.	Housewares	725.8	716.3	−1.3
XIX.	Major Appliances	239.2	243.5	1.8
XX.	Radio and Television	109.4	104.0	−4.9
	Groups I–XV: Soft Goods	457.8	468.3	2.3
	Groups XVI–XX: Durable Goods	444.7	443.8	−0.2
	Store Total	454.1	462.0	1.7

[1]Absence of a minus sign before percentage change in this column signifies price increase.

26 CFR 1.472-1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The August 1985 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, August 31, 1985.

Rev. Rul. 85-180

The following price indexes for August 1985 were issued by the Bureau of Labor Statistics on September 26, 1985, for use by department stores, and are accepted by the Internal Revenue Service, under section 1.472-1(k) of the Internal Revenue Service, under section 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 72-21, 1972-1 C.B. 745, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with ence to, August 31, 1985.

Indexes are prepared on a n basis for the store total, for 20 groups of departments, and f special combinations—soft and goods. The store total index co departments, including some no separately, with the following tions: candy, foods, liquor, to paints, and wallpaper, as well tract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100)

		August 1984	August 1985	Percentage Change fro August 1984 August 198
I.	Piece Goods	402.5	393.6	−2.2
II.	Domestics and Draperies	544.1	538.7	−1.0

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE
INVENTORY PRICE INDEXES BY DEPARTMENNT GROUPS
(January 1941 = 100)—Continued

		August 1984	August 1985	Percentage Change from August 1984 to August 1985[1]
III.	Women's and Children's Shoes	537.9	539.0	0.2
IV.	Men's Shoes	701.8	712.6	1.5
V.	Infants' Wear	475.6	493.3	3.7
VI.	Women's Underwear	423.8	432.7	2.1
VII.	Women's and Girls' Hosiery	233.8	235.2	0.6
VIII.	Women's and Girls' Accessories	438.3	448.1	2.2
IX.	Women's Outerwear and Girls' Wear	329.5	338.1	2.6
X.	Men's Clothing	464.3	469.9	1.2
XI.	Men's Furnishings	461.5	478.6	3.7
XII.	Boys' Clothing and Furnishings	435.2	438.7	0.8
XIII.	Jewelry	694.6	682.1	−0.4
XIV.	Notions	483.2	487.4	0.9
XV.	Toilet Articles and Drugs	619.8	643.6	3.8
XVI.	Furniture and Bedding	520.0	534.5	2.8
XVII.	Floor Coverings	453.4	461.6	1.8
XVIII.	Housewares	724.6	719.7	−0.7
XIX.	Major Appliances	239.6	244.0	1.8
XX.	Radio and Television	109.3	103.3	−5.5
	Groups I–XV: Soft Goods	467.0	474.8	1.7
	Groups XVI–XX: Durable Goods	443.7	445.7	0.5
	Store Total	460.3	467.0	1.5

[1]Absence of a minus sign before percentage change in this column signifies price increase.

26 CFR 1.472-1: Last-in, first-out inventories

LIFO; price indexes; department stores. The September 1985 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, September 30, 1985.

Rev. Rul. 85-185

The following price indexes for September 1985 were issued by the Bureau of Labor Statistics on October 2, 1985, for use by department stores, and are accepted by the Internal Revenue Service, under section 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 72-21, 1972-1 C.B. 745, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, September 30, 1985.

Indexes are prepared on a national basis for the store total, for 20 major groups of departments, and for two special combinations—soft and durable goods. The store total index covers all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, paints, and wallpaper, as well as contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100)

		September 1984	September 1985	Percentage Change from September 1984 to September 1985[1]
I.	Piece Goods	398.9	396.0	−0.7
II.	Domestics and Draperies	563.4	554.5	−1.6

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENNT GROUPS
(January 1941 = 100)—Continued

		August 1985	August 1984	Percentage Change from September 1984 September 1985
III.	Women's and Children's Shoes	553.1	545.7	−1.3
IV.	Men's Shoes	707.5	712.4	0.7
V.	Infants' Wear	483.1	497.2	2.9
VI.	Women's Underwear	426.8	438.6	2.8
VII.	Women's and Girls' Hosiery	236.1	234.8	−0.6
VIII.	Women's and Girls' Accessories	443.1	450.0	1.6
IX.	Women's Outerwear and Girls' Wear	351.0	362.4	3.2
X.	Men's Clothing	471.6	474.9	0.7
XI.	Men's Furnishings	469.0	492.0	4.9
XII.	Boys' Clothing and Furnishings	441.4	455.4	3.2
XIII.	Jewelry	692.4	669.3	−3.3
XIV.	Notions	483.8	488.1	0.9
XV.	Toilet Articles and Drugs	623.7	645.5	3.5
XVI.	Furniture and Bedding	532.3	529.8	−0.5
XVII.	Floor Coverings	454.4	452.1	−0.5
XVIII.	Housewares	717.2	716.5	−0.1
XIX.	Major Appliances	244.3	247.5	1.3
XX.	Radio and Television	109.2	102.4	−6.2
	Groups I–XV: Soft Goods	478.6	485.9	1.5
	Groups XVI–XX: Durable Goods	446.1	442.9	−0.7
	Store Total	469.0	474.0	1.1

[1]Absence of a minus sign before percentage change in this column signifies price increase.

26 CFR 1.472-2: Requirements incident to adoption and use of LIFO inventory method.

LIFO; conformity requirements. A taxpayer may use the specific goods method of inventory pricing under the last-in, first-out (LIFO) inventory method for financial reporting purposes and the dollar-value method of pricing inventories under the LIFO inventory method for federal income tax purposes without violating the conformity requirements of section 472(c) and (e) of the Code.

Rev. Rul. 85-129

ISSUE

May a taxpayer using the last-in, first-out (LIFO) method to inventory goods use the dollar-value method to compute the value of its inventory for federal income tax purposes and the specific goods method to compute the value of its inventory for financial reporting purposes, without violating the conformity requirements of section 472(c) and 472(e) of the Internal Revenue Code?

FACTS

The taxpayer, a domestic corporation, has used the specific goods method of pricing inventories under the LIFO inventory method for a number of years. For the tax year ended December 31, 1981, the taxpayer received permission from the Commissioner of Internal Revenue to change its specific goods method of pricing to the dollar-value method of pricing under the LIFO inventory method.

The taxpayer, for its tax year ended December 31, 1981, used the specific goods method of pricing inventories under the LIFO inventory method for its financial statements issued as part of its annual report. The taxpayer used the dollar-value method of pricing inventories under the LIFO inventory method for federal income tax purposes for that year.

The issue is whether the use of t specific goods method for financial porting and the dollar-value method federal income tax purposes violat the conformity requirements of secti 472(c) and 472(e) of the Code.

LAW AND ANALYSIS

Section 472(b)(1) of the Code p vides that, in adopting the LIFO inv tory method, goods in the ending ventory shall be treated as compos first of goods included in the openi inventory (in the order of acquisitio to the extent thereof and then of goo acquired in the tax year. Secti 472(b)(3) provides that goods in t opening inventory for the tax year adoption shall be treated as havi been acquired at the same time a their costs determined under the av age cost method. Section 472(b)(2) quires a taxpayer to value its invento at cost. There are two methods for d termining the cost of inventories und

the LIFO inventory method; the specific goods method and the dollar-value method. The specific goods method is described in section 1.472-1 of the Income Tax Regulations and the dollar-value method is described in section 1.472-8.

Section 472(c) of the Code provides that a taxpayer must not have used any procedure other than the LIFO procedure in inventorying goods included within the LIFO election to ascertain the income, profit, or loss of the first tax year it uses the LIFO method for the purpose of reports to shareholders, proprietors, beneficiaries or creditors.

Section 472(e) of the Code imposes substantially the same requirements as section 472(c) on subsequent taxable years and authorizes the Secretary of the Treasury to require the taxpayer to change to another method of inventory identification and valuation when this requirement has not been met.

Section 1.472-2(e)(1) of the regulations requires that taxpayers must establish to the satisfaction of the Commissioner that the taxpayer, in ascertaining the income, profit, or loss for the tax year for which the LIFO inventory method is first used, or for any subsequent tax year, for credit purposes or for purposes of reports to shareholders, partners, or other proprietors, or to beneficiaries, has not used any inventory method other than that referred to in section 1.472-1 (LIFO inventory method) or at variance with the requirement referred to in section 1.472-2(c).

Section 1.472-2(e)(1) of the regulations describes in subparagraphs (i) through (viii) situations that are not considered at variance with the requirements of paragraph (e)(1). The subparagraph relevant to the taxpayer's situation is (vi). Section 1.472-2(e)(1)(vi) provides that a taxpayer may use a costing method or accounting method to ascertain income, profit, or loss for credit purposes or for purposes of financial reports if such costing method or accounting method is either inconsistent with the inventory method referred to in section 1.472-1 (LIFO inventory method) nor at variance with the requirement referred to in section 1.472-2(c), regardless of whether such costing method or accounting method is used by the taxpayer for federal income tax purposes. The specific goods method is the method referred to in section 1.472-1. Section 1.472-2(e)(1)(vi) refers to section 1.472-2(e)(8) for examples of such costing methods and accounting methods; however, the examples are not all-inclusive.

The conformity requirement of section 472 of the Code states that a taxpayer using the LIFO inventory method for federal income tax purposes may not use a method other than the LIFO method for financial reporting or other purposes. The taxpayer's continued use of the specific goods method of pricing for financial reporting purposes is the use of the LIFO method.

HOLDING

The taxpayer may use the dollar-value method of pricing under the LIFO inventory method for federal income tax purposes and continue to value its LIFO inventories on the specific goods method for financial reporting purposes without violating the conformity requirements of section 472(c) and 472(e) of the Code.

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26 CFR 1.472-6: Change from LIFO inventory method.

Procedures are provided for taxpayers that use the LIFO inventory method of accounting and that issued nonconforming financial statements under section 472(g) of the Code to automatically discontinue the use of the LIFO inventory method for their first tax year beginning on or after July 18, 1984. See Rev. Proc. 85-54, page 734.

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26 CFR 1.472-8: Dollar-value method of pricing LIFO inventories.
(Also Section 351.)

Inventories; LIFO; transferor corporation; basis. A corporation using the dollar-value LIFO inventory method that transfers a portion of its inventories to a subsidiary in a nontaxable transaction must compute its basis in the inventories transferred in accordance with the procedures established in section 1.472-8(g)(2) of the regulations.

Rev. Rul. 85-176

ISSUE

How does a corporation that uses the dollar-value last-in, first-out (LIFO) inventory method and that transfers a portion of its inventories in a nontaxable exchange under section 351 of the Internal Revenue Code compute its basis in the inventories transferred.

FACTS

X corporation, a calendar year taxpayer, manufactures product *A*. *X* elected, in 1976, to determine the cost of its entire inventory using the dollar-value LIFO method and one natural business unit pool.

On June 5, 1983, for valid business reasons, *X* transferred one-half of its production plant to *Y*, a newly organized subsidiary, in a nontaxable exchange under section 351(a) of the Code. Included in the assets transferred to *Y* was one-half of the inventories with respect to which *X* used the dollar-value LIFO inventory method. The question presented is whether the basis of the transferred LIFO inventory is determined by reference to the current year costs (horizontal slice), or on a pro rata basis (vertical slice) which takes into account a portion of the base-year layer and subsequent yearly increments.

LAW AND ANALYSIS

Section 472(a) of the Code authorizes taxpayers to use the LIFO method of inventorying goods. It also requires the promulgation of regulations to insure that use of the LIFO method will clearly reflect income.

Section 472(b)(1) of the Code requires taxpayers using the LIFO inventory method to treat goods "remaining on hand at the close of the taxable year as being: First, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof; and second, those acquired in the taxable year . . ." The LIFO method of pricing inventories is based upon an assumption about the flow of costs: the latest price paid for an item is reflected in the cost of goods sold.

Section 1.472-8 of the Income Tax Regulations defines the dollar-value method of valuing LIFO inventories. Under this method, inventories are grouped into pools and valued by using a base-year cost expressed in terms of total dollars rather than using the quantity and price of specific goods as the unit of measurement. Any taxpayer that elects the LIFO inventory method may also elect to determine the cost of its LIFO inventories under the dollar-value method, provided the dollar-value

method is used consistently and clearly reflects the income of the taxpayer in accordance with the rules of section 1.472-8.

Section 1.472-8(b) of the regulations provides guidelines for the use of natural business unit pools by manufacturers. A natural business unit ordinarily consists of the entire productive activity of the enterprise; that is, raw materials, goods in process, and finished goods.

Section 1.472-8(e)(2)(iv) of the regulations provides that to determine whether there is an increment or liquidation in a pool for a particularly taxable year, the end of the year inventory of the pool expressed in terms of base-year cost is compared with the beginning of the year inventory of the pool expressed in terms of base-year cost. If, at the end of a taxable year, the ending inventory of a pool is less than the opening inventory of the pool, a liquidation has occurred. The liquidation is reflected by reducing the most recent layer of increment by the excess of the beginning of the year inventory over the end of the year inventory of the pool. When the amount of the liquidation exceeds the amount of the most recent layer of increment, the preceding layers of increment in reverse chronological order are successively reduced by the amount of such excess until all the excess is absorbed.

Section 1.472-8(g)(2) of the regulations provides a procedure for combining or separating dollar-value pools. When dollar-value pools are separated, the base-year and LIFO layers of increment are separated on a pro rata basis. Thus, each yearly layer of increment in the divided pool is separately accounted for in the new pools, and any liquidation occurring in the new pools after their formation is treated as if the pools had existed from the date the taxpayer first adopted the LIFO method.

Section 351 of the Code provides that no gain or loss shall be recognized if property is transferred to a corporation solely in exchange for its stock or securities, and if the transferor or transferors control the corporation immediately after the exchange. The premise of section 351 is that a transfer of property to a corporation controlled by the transferor works a change of form only and is not an appropriate time for the transferor to recognize gain or loss on the transferred property. If a transaction qualifies under section 351, the basis of the stock received by a transferor is the same as the basis of the property given up, under section 358, and the transferee corporation's basis for the property is the same as was the transferor's, under section 362.

Rev. Rul. 70-565, 1970-2 C.B. 110, discusses the treatment of the basis of transferred LIFO inventory in a transaction that qualifies under section 351 of the Code when both transferor and transferee are using the LIFO inventory method. Rev. Rul. 70-565 holds that a corporation using the LIFO inventory method that acquires LIFO inventories in a nontaxable exchange under section 351(a) is required to integrate the basis of the LIFO inventories acquired into its own corresponding LIFO layers using the acquisition dates and costs of the transferor. The rationale for the holding is that, since the underlying purpose of the LIFO method of inventory accounting is to match current income with current costs, the inventory received through a nontaxable contribution to capital does not represent current costs to the transferee and the use of the date of transfer as the acquisition cost date would undercut the underlying assumption of the LIFO method. Therefore, the transferee is required to integrate the transferor's LIFO layers into its own corresponding layers. *See also, Commissioner v. Joseph E. Seagram & Sons, INc.*, 394 F.2d 738 (2nd Cir. 1968), *reversing* 46 T.C. 698 (1966).

In this case, the pro rata division of the base-year costs and subsequent yearly increments under the provisions of section 1.472-8(g)(2) of the regulations would be consistent with the underlying purpose of the LIFO inventory method. Thus, the concept of matching current income with current costs under the LIFO method of inventory accounting is satisfied. The use of any other method to compute the portion of inventories transferred in a nontaxable exchange under section 351 of the Code would inappropriately treat the nontaxable transaction as if it were another sale of goods out of inventory.

If the transferee, *(Y)* in this situation, desires to adopt the LIFO method for the acquired inventory, the transferee must file Form 970 and determine opening inventory by the average cost method. Rev. Rul. 70-564, 1970-2 C.B. 109.

HOLDING

A corporation that uses the dollar-value LIFO inventory method and transfers a portion of its inventories in a nontaxable exchange under section 351 of the Code must compute its basis in the inventories transferred using a pro rata (vertical) division of the base-year and subsequent yearly incremental costs in accordance with the procedures established in section 1.472-8(g)(2) of the regulations.

Part III.—Adjustments

Section 481.—Adjustments Required by Changes in Methods of Accounting

26 CFR 1.481-1: Adjustments in general. (Also Section 446; 1.446-1.)

Accounting methods; incorporation of partnership's business after change; treatment of unamortized section 481(a) adjustment. When one of the two trades or businesses of a partnership is incorporated, the partnership is required to accelerate the portion of an unamortized section 481(a) adjustment applicable to that trade or business. Rev. Ruls. 77-264 and 80-39 amplified.

Rev. Rul. 85-134

ISSUE

When one of the two trades or businesses of a partnership is incorporated, is the partnership *(PRS)* required to accelerate the portion of an unamortized adjustment under section 481(a) of the Internal Revenue Code applicable to that trade or business?

FACTS

PRS commenced business in 1965 and established two separate businesses, a "professional" business and a "technical" business. As a result of expansion, *PRS*'s accounts receivable and liabilities increased and *PRS* determined that the cash receipts and disbursements method of accounting no longer properly reflected its activities. Therefore, *PRS* applied for and received permission to change its method of accounting for federal income tax

purposes to an accrual method for its tax year ended March 31, 1980. The ruling letter issued by the Internal Revenue Service stated that the adjustment required under section 481(a) of the Code would be taken into account over a 10-year period beginning with the year of the change. The ruling also stated that if *PRS* ceased to be engaged in a trade or business with respect to which the change applied, the unamortized section 481(a) adjustment with respect to that trade or business would be taken into account in the year it ceased to be engaged in that particular trade or business. On April 1, 1982, the professional business of *PRS* was incorporated.

LAW AND ANALYSIS

Section 446(e) of the Code requires a taxpayer to secure the consent of the Commissioner before changing a method of accounting. Section 1.446-1(e)(3)(i) of the Income Tax Regulations states that in order to secure the consent of the Commissioner, the taxpayer must agree to the terms, conditions, and adjustments under which the change will be effected.

Section 481(a) of the Code provides that in computing a taxpayer's taxable income for the tax year for which there has been a change in method of accounting initiated by the taxpayer, there shall be taken into account those adjustments that are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted.

Rev. Rul. 77-264, 1977-2 C.B. 187, describes a situation in which the sole proprietor of a retail store obtained permission to effect a change in method of accounting, agreeing to take into account ratably over a 10-year period the adjustments required under section 481(a) of the Code and to include in income the balance of the adjustment determined under section 481(a) upon ceasing to engage in the trade of business. Three years later the sole proprietor incorporated the business. Rev. Rul. 77-264 holds that the taxpayer is no longer engaged in that particular trade or business and, therefore, the balance of the adjustment determined under section 481(a), to the extent not previously taken into account, must be taken into account in computing taxable income in the tax year in which the taxpayer ceased to engage in that particular trade or business.

Rev. Rul. 80-39, 1980-1 C.B. 112, describes a domestic corporation that carries out its business operations through several divisions. Each division is in a different trade or business, and each keeps a complete and separate set of books and records. The corporation seeks permission to change its method of accounting for the trade or business conducted by one of the divisions. Rev. Rul. 80-39 holds that, in granting a change in method of accounting, the Service will impose a condition that requires any balance of a section 481(a) adjustment applicable to the trade or business conducted by that division to be reported in the tax year in which the corporation ceases to engage in that trade or business.

Before April 1, 1982, *PRS* had two separate businesses. The ruling letter granting *PRS* permission to change to an accrual method of accounting provides that, "in the event your partnership ceases to engage in a trade or business with respect to which the change applies at any time prior to the expiration of the 10-year period, the balance of the adjustment with respect to that trade or business not previously taken into account in computing ordinary income shall be taken into account in such year." By incorporating the professional business on April 1, 1982, *PRS* ceased to engage in that particular trade or business as of that date. *See* Rev. Rul. 77-264 and *Shore v. Commissioner*, 69 T.C. 689 (1978), *aff'd*, 631 F.2d 624 (9th Cir. 1980). A portion of the section 481(a) adjustment resulting from the earlier change in method of accounting by *PRS* from the cash method to the accrual method is attributable to the professional business. To allow *PRS* to continue to report the section 481(a) adjustment applicable to the professional business over years subsequent to the time *PRS* ceases to engage in that particular trade or business would distort the income of *PRS* during the remaining adjustment period. *See* Rev. Rul. 80-39 and Section 5.09(2) of Rev. Proc. 84-74, 1984-2 C.B. 736.

HOLDING

PRS is required to accelerate the portion of the unamortized adjustment under section 481(a) of the Code applicable to the trade or business incorporated.

EFFECT ON OTHER DOCUMENTS

Rev. Ruls. 77-264 and 80-39 are amplified.

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26 CFR 1.481-1: Adjustments in general.

Procedures are provided for taxpayers using the cash receipts and disbursements method of accounting to obtain expeditious consent to change their overall method of accounting to the accrual method. See Rev. Proc. 85-36, page 434, and Rev. Proc. 85-37, page 438.

Section 483.—Interest on Certain Deferred Payments

Federal short-term, mid-term and long-term rates determined under the alternate method as provided by section 1.1274-6T of the Temporary Income Tax Regulations are set forth for the month of July 1985. See Rev. Rul. 85-91, page 187.

Federal short-term, mid-term and long-term rates determined under the alternate method as provided by section 1.1274-6T of the Temporary Income Tax Regulations are set forth for the month of August 1985. See Rev. Rul. 85-117, page 187.

Federal short-term, mid-term and long-term rates determined under the alternate method as provided by section 1.1274-6T of the Temporary Income Tax Regulations are set forth for the month of September 1985. See Rev. Rul. 85-137, page 187.

Federal short-term, mid-term and long-term rates determined under the alternate method as proved by section 1.274-6T of the Temporary Income Tax Regulations are set forth for the month of October 1985. See Rev. Rul. 85-154, page 188.

Federal short-term, mid-term and long-term rates determined under the alternate method as provided by section 1.1274-6T of the Temporary Income Tax Regulations are set forth for the month of November 1985. See Rev. Rul. 85-181, page 188.

Federal short-term, mid-term and long-term rates determined under the alternate method as provided by section 1.1274-6T of the Temporary Income Tax Regulations are set forth for the month of December 1985. See Rev. Rul. 85-190, page 186.

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26 CFR 1.483-1: Computation of interest on certain deferred payments.

What are the applicable federal rates to be used for purposes of section 483? See Rev. Rul. 85-170, page 186.

Subpart F.—Exempt Organizations
Part 1.—General Rule

Section 501.—Exemption from Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.
(Also Sections 508, 4947; 1.508-3, 53.4947-1.)

Qualification; private foundation; governing instrument provision; dissolution requirements. Provisions in an organization's governing instrument that satisfy the requirements of section 508(e) of the Code, for purposes of qualification for exemption under section 501(a) as a private foundation, are not in themselves sufficient to meet the requirement of section 1.501(c)(3)-1(b)(4) of the regulations that, upon dissolution, the organization's assets be dedicated to an exempt purpose.

Rev. Rul. 85-160

ISSUE

Does an organization that would be classified as a private foundation if it were described in section 501(c)(3) of the Internal Revenue Code, satisfy the organizational test set forth in section 1.501(c)(3)-1(b)(4) of the Income Tax Regulations by virtue of having satisfied the governing instrument provision of section 508(e)?

FACTS

M seeks recognition of exemption under section 501(c)(3) of the Code and is an organization that would, if described in section 501(c)(3), be classified as a private foundation within the meaning of section 509(a). *M* does not have a provision in its articles of incorporation requiring the distribution of its assets for charitable purposes upon dissolution. The state nonprofit statute under which *M* incorporated has not been construed to operate in a manner that assures dedication of assets to charitable purposes.[1] However, *M*'s state of incorporation does have a statute that imposes the requirements of section 508(e) on all private foundations formed in that state, in accordance with section 1.508-3(d) of the Income Tax Regulations. See Rev. Rul. 75-38, 1975-1 C.B. 161, which lists those states that have been held by the Service to have adopted legislation satisfying the requirements of section 508(e).

LAW AND ANALYSIS

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(b)(4) of the regulations provides that:

Distribution of assets on dissolution. An organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the federal government, or to a State or local government, for a public purpose, or would be distributed by a court to another organization to be used in such manner as in the judgment of the court will best accomplish the general purposes for which the dissolved organization was organized. However, an organization does not meet the organizational test if its articles or the law of the State in which it was created provide that its assets would, upon dissolution, be distributed to its members or shareholders.

Section 508(e) of the Code provides that a private foundation shall not be exempt from taxation under section 501(a) unless its governing instrument provides that it distribute its income annually to avoid tax under section 4942, not engage in any act of self-dealing as defined in section 4941(d), not retain any excess business holdings as defined in section 4943(c), not make any jeopardizing investments resulting in tax under section 4944, and not make any taxable expenditures as defined in section 4945(d).

Section 1.508-3(d)(1) of the regulations provides that:

Effect of State Law—In General. A private foundation's governing instrument shall be deemed to conform with the requirements of paragraph (a) of this section if valid provisions of State law have been enacted which:

(i) Require it to act or refrain from acting so as not to subject the foundation to the taxes imposed by section 4941 (relating to taxes on self-dealing), 4942 (relating to taxes on failure to distribute income), 4943 (relating to taxes on excess business holdings), 4944 (relating to taxes on investments which jeopardize charitable purpose), and 4945 (relating to taxable expenditures); or

(ii) Treat the required provisions as contained in the foundation's governing instrument.

Section 508(e) of the Code applies only to a private foundation. Section 509(a) defines the term private foundation as an "organization described in section 501(c)(3) . . ." An organization that does not meet the requirements of section 1.501(c)(3)-1(b)(4) of the regulations as to dissolution is not "described in section 501(c)(3)."

The legislative history of sections 508(e) and 509(a) of the Code makes it clear that the requirements set out in section 508(e) are additional to those found in section 501(c)(3). For example, see H.R. Rep. No. 91-413 (Part I), Committee Report to accompany the Tax Reform Act of 1969, 91st Cong., 1st Sess. 40 (1969), 1969-3 C.B. 200, 226, which, in regard to "effective assurance . . . that the assets and organizational structure dedicated to charity will in fact be used for charity," states that:

> the bill provides as an *additional condition of exemption for private foundations* the requirement that the governing instrument require current distributions of income (sec. 4942) and prohibit self-dealing (sec. 4941), retention of excess business holdings (sec. 4943), speculative investments (sec. 4944), and taxable expenditures . . . . Your committee intends and expects that this requirement will add to the enforcement tools available to State officials charged with supervision of charitable organizations. [emphasis added.]

See also S. Rep. No. 91-552, 91st Cong., 1st Sess. 56 (1969), 1969-3 C.B. 423, 460.

[1] See Rev. Proc. 82-2, 1982-1 C.B. 367, for a list of states having laws providing for distribution of assets upon dissolution of nonprofit trusts, corporations, and unincorporated associations, which laws satisfy section 1.501(c)(3)-1(b)(4) of the regulations.

HOLDING

M does not satisfy the organizational test with respect to dissolution requirements set forth in section 1.501(c)(3)-1(b)(4) of the regulations, by virtue of satisfying the governing instrument provisions applicable to private foundations under section 508(e).

This revenue ruling does not apply to nonexempt charitable trusts that are private foundations by virtue of section 4947(a)(1) because section 4947(a)(1) treats them as described in section 501(c)(3) regardless of the dissolution provision.

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26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Whether Service will follow the decision in *St. Luke's Hospital of Kansas City v. United States*, 494 F. Supp. 85 (W.D. Mo., 1980), to the extent that it holds that a tax-exempt hospital's performance of diagnostic laboratory testing upon specimens from patients of the hospital's staff physicians is not unrelated trade or business because the activity is performed primarily for the convenience of members of the hospital under section 513(a)(2) of the Code. See Rev. Rul. 85-109, page 165.

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26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Whether the provision of diagnostic laboratory testing services by health organizations exempt from Federal income tax under section 501(c)(3) of the Code is unrelated trade or business within the meaning of the section 513. See Rev. Rul. 85-110, page 166.

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26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary or educational purposes, or for the prevention of cruelty to children or animals.

Whether an organization that has no gross receipts for its first two taxable years but receives total support of more than $15,000 in contributions from the general public in its third taxable year, meets the requirements of section 508(a) of the Code if it files for exemption within 90 days after the close of its third taxable year. See Rev. Rul. 85-173, page 164.

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26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Whether scholarship grants awarded by a trust exempt from federal income tax under section 501(c)(3) of the Code, under a procedure that gives preference to family members and relatives of the trust's grantor, are awarded on an objective and nondiscriminatory basis as required by section 4945(g). See Rev. Rul. 85-175, page 276.

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26 CFR 1.501(c)(5)-1: Labor, agricultural, and horticultural organizations.

Whether sales activity at a convention or trade show results in unrelated business taxable income. Rev. Ruls. 75-517, 75-518, 75-519, and 75-520 are revoked for taxable years beginning after October 4, 1976. Rev. Rul. 67-219 and Rev. Rul. 75-516 are obsoleted for taxable years beginning after October 4, 1976. See Rev. Rul. 85-123, page 168.

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26 CFR 1.501(c)(6)-1: Business league, chambers of commerce, real estate boards, and boards or trade.

Whether sales activity at a convention or trade show results in unrelated business taxable income. Rev. Ruls. 75-517, 75-518, 75-519, and 75-520 are revoked for taxable years beginning after October 4, 1976. Rev. Rul. 67-219 and Rev. Rul. 75-516 are obsoleted for taxable years beginning after October 4, 1976. See Rev. Rul. 85-123, page 168.

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26 CFR 1.501(c)(9)-1: Voluntary employees' beneficiary associations, in general.

Qualification; voluntary employees' beneficiary association; one employee member. A trust created to provide life, sick, accident, and other benefits to only one employee does not qualify for exemption under section 501(c)(9) of the Code.

Rev. Rul. 85-199

ISSUE

Does a trust that provides life, sick, accident, and other benefits to one employee qualify for exemption from federal income tax under section 501(c)(9) of the Internal Revenue Code?

FACTS

The trust was created for the purpose of providing life, sick, accident, and other benefits to its members. All employees of a specified professional corporation are eligible to be members. However, the professional corporation has only one employee, a dentist, who is also a shareholder and an officer of the corporation. The trust's income is derived from contributions by the professional corporation and from investment income. Disbursements are for benefits and administrative costs.

LAW AND ANALYSIS

Section 501(c)(9) of the Code provides for the exemption from federal income tax of voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries, if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-1 of the Income Tax Regulations provides that to be described in section 501(c)(9) of the Code an organization must be an employees' association.

Section 1.501(c)(9)-2(a)(1) of the regulations provides that the membership of an organization described in section 501(c)(9) of the Code must consist of individuals who become entitled to participate by reason of their being employees and whose eligibility for membership is defined by reference to objective standards that constitute an employment-related common bond among such individuals.

In order to qualify for exemption as a voluntary employees' beneficiary association under section 501(c)(9) of the Code, an organization must be an employees' association, and its membership must consist of individuals sharing an employment-related common bond. The requirement that an organization be an employees' association indicates that the organization must be formed on behalf of employees who associate together to receive the benefits provided by the organization. An organization with only a single employee member does not meet this requirement.

HOLDING

A trust that provides life, sick, accident, and other benefits to one employee does not qualify for exemption from federal income tax as a voluntary employees' beneficiary association under section 501(c)(9) of the Code.

Section 503.—Requirements for Exemption

26 CFR 1.503(b)-1: Prohibited transactions.

Prohibited transaction; loan to employer; unrecorded deed of trust. A loan made by an exempt employees'

trust of a governmental plan to its employer-grantor evidenced by a note bearing a reasonable rate of interest, but secured only by a unrecorded deed of trust on real property owned by the grantor, was not adequately secured and constituted a prohibited transaction under section 503(b)(1) of the Code. Rev. Rul. 73-586 superseded.

Rev. Rul. 85-114

PURPOSE

The purpose of this revenue ruling is to restate the position in Rev. Rul. 73-586, 1973-2 C.B. 186, in view of the enactment of the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 1974-3 C.B. 1.

ISSUE

The issue in Rev. Rul. 73-586 is whether a loan made by an employees' trust, under the circumstances described below, constitutes a prohibited transaction within the meaning of section 503 of the Internal Revenue Code.

FACTS

An employees' trust that met the requirements of section 401(a) of the Code and was exempt from Federal income tax under section 501(a) was established as part of a governmental plan referred to in section 4975(g)(2). A loan was made to the employer-creator of the trust and was evidenced by a note bearing a reasonable rate of interest. It was secured only by a deed of trust on real property owned by the employer. However, the deed of trust was not recorded. Furthermore, the loan did not satisfy the conditions of section 503(e) or (f).

The law of the state in which the real property is located and the transaction occurred provides that "a deed of trust is not valid as against any class of persons with any kinds of rights, except between the parties thereto and such as have notice thereof, until the time such deed of trust is recorded."

LAW AND ANALYSIS

Section 503(a)(1)(B) of the Code states that an organization described in section 401(a) of the Code which is referred to in section 4975(g)(2) or (3) of the Code shall not be exempt from taxation under section 501(a) if it has engaged in a prohibited transaction after March 1, 1954.

Section 4975(g)(2) and (3) of the Code refers to governmental plans within the meaning of section 414(d) and church plans, within the meaning of section 414(e), with respect to which the election provided by section 410(d) has not been made.

Section 503(b)(1) of the Code provides that, for purposes of that section, the term "prohibited transaction" includes any transaction in which a qualified employees' trust subject to the provisions of that section lends any part of its income or corpus, without the receipt of adequate security and a reasonable rate of interest, to the creator of such organization. In this case, the creator of the section 401(a) organization was the employer.

Section 1.503(b)-1(b)(1) of the Income Tax Regulations defines the term "adequate security" to mean something in addition to and supporting a promise to pay, which is so pledged to the organization that it may be sold, foreclosed upon, or otherwise disposed of in default of repayment of the loan, the value and liquidity of which security is such that it may reasonably be anticipated that loss of principal or interest will not result from the loan.

Rev. Rul. 80-269, 1980-2 C.B. 191, holds that where a chattel mortgage was not recorded as soon as practicable, and the personal property was not specifically identified, the loan intended to be secured by the mortgage constituted a prohibited transaction. That revenue ruling points out that the chattel mortgage, until filed, is enforceable only between the parties; and the rights of intervening third parties without knowledge of the unrecorded mortgage may weaken the value of such security. It also states that it is necessary, in order to satisfy the requirements of the regulations, that the chattel mortgage be recorded as soon as practicable and the personal property be specifically identified.

In this case, as in Rev. Rul. 80-269, the rights of intervening third parties without knowledge of the unrecorded security may weaken the value of such security. Hence, the unrecorded deed of trust does not constitute adequate security for the loan.

HOLDING

The loan constitutes a prohibited transaction within the meaning of section 503(b)(1) of the Code.

EFFECT ON OTHER REVENUE RULINGS

Revenue Ruling 73-586 is superseded because the position stated therein is restated in this revenue ruling.

Part II.—Private Foundations

Section 508.—Special Rules With Respect To Section 501(c)(3) Organizations

26 CFR 1.508-1: Notices.
(Also Section 501; 1.501(c)(3)-1.)

Rulings; timely notification of application for exemption. An organization that has no gross receipts in its first two taxable years, but receives more than $15,000 in contributions from the general public in its third taxable year, meets the notice requirement of section 508(a) of the Code if it files for exemption under section 501(c)(3) within 90 days after the close of its third taxable year. It will be recognized as exempt as of the date of its organization. Rev. Rul. 80-113 modified.

Rev. Rul. 85-173

ISSUE

Whether an organization that has no gross receipts for its first two taxable years, but receives total support of more than $15,000 in contributions from the general public in its third taxable year, meets the requirements of section 508(a) of the Internal Revenue Code and therefore can be recognized as exempt from the date of its organization, by filing for exemption under section 501(c)(3) within 90 days after the close of its third taxable year.

FACTS

A nonprofit organization had no financial support for either its first taxable year consisting of less than eight months or its second taxable year. In its third year, it received total support of more than $15,000 in contributions from the general public. The organization applied for recognition of exemption under section 501(c)(3) of the

ode within 90 days after the close of e third taxable year.

AW AND ANALYSIS

Section 508(a) of the Code provides at an organization, other than one described in section 508(c), organized after October 9, 1969, shall not be eated as an organization described in ection 501(c)(3) unless it has given otice to the Secretary, in such manner the Secretary may be regulations escribe, that it is applying for recogtion of such status.

Section 1.508-1(a) of the Income ax Regulations provides, in part, that organization seeking exemption unr section 501(c)(3) of the Code must, ithin fifteen months from the end of e month in which it was organized, ve the Commissioner notice that it is pplying for exemption. If it fails to ve notice within this period, it will be eated as exempt, provided it otherise qualifies, only from the date it les its application constituting such otice.

Section 508(c)(1)(B) of the Code rovides that section 508(a) shall not pply to any organization which is not private foundation under section 509 d the gross receipts of which in each xable year are normally not more an $5,000.

Section 1.508-1(a)(3)(ii) of the regutions provides that the gross receipts f an organization are normally not ore than $5,000 if—

(a) During the first taxable year of e organization, the organization has eceived gross receipts of $7,500 or ss

(b) During its first two taxable years e aggregate gross receipts received by e organization are $12,000 or less; nd

(c) In the case of an organization hich has been in existence for at least ree taxable years, the aggregate gross ceipts received by the organization uring the immediately preceding two xable years plus the current year are 5,000 or less.

he regulations further provide that if n organization fails to meet the reuirements of (a), (b), or (c), then the rganization shall be required to file the otice described in section 508(a) of e Code within 90 days after the close f the period described in (a), (b), or (c) in lieu of within the period described in section 1.508-1(a)(2)(i) of the regulations.

Section 509 of the Code provides that an organization described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)) is not a private foundation.

Section 1.170A-9(e)(5)(v)*(c)* of the regulations provides that if an organization's first taxable year consists of less than eight months, a computation period of three taxable years applies for the initial determination of the sources of support of the organization for purposes of determining whether it is an organization described in section 170(b)(1)(A)(vi).

Rev. Rul. 80-113, 1980-1 C.B. 58, holds that an organization with no financial support that seeks nonprivate foundation status under section 509(a)(1) and section 170(b)(1)(A)(vi) and that files the notice required by section 508(a) of the Code more than fifteen months after the end of the month in which it was organized, can only be recognized as exempt for the period beginning on the date that the notice is filed. Such an organization is not described in section 170(b)(1)(A) as other than a private foundation on the date of filing. Therefore, the section 508(c)(1)(B) exception to the notice requirement does not apply.

In the present case, the three year computation period of section 1.170A-9(e)(v)*(c)* of the regulations is applicable to the organization. In its first three taxable years it received total support of more than $15,000 in contributions from the general public, removing it from the definition of a private foundation. The organization applied for recognition of its exempt status within 90 days after the close of the taxable year in which it exceeded the $15,000 gross receipts limit of section 1.508-1(a)(3)(ii) of the regulations, thereby fulfilling the requirements of section 508(a) of the Code. Therefore, it can be recognized as exempt from the date of its organization.

HOLDING

An organization that has no gross receipts in its first taxable year consisting of less than eight months, no gross receipts in its second taxable year, and total support of more than $15,000 in contributions from the general public in its third taxable year, meets the requirements of section 508(a) of the Code if it files for exemption under section 501(c)(3) within 90 days after the close of its third taxable year. Therefore, it can be recognized as exempt as of the date of its organization.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 80-113, *supra*, is modified to indicate that should an organization described in that revenue ruling receive public support subsequent to its application date and prior to the expiration of the computation period provided in section 1.170A-9(e)(5) of the regulations, exemption would be recognized back to the date of organization.

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26 CFR 1.508-3: Governing instruments.

Whether an organization, which otherwise qualifies as a private foundation, satisfies the organizational test set forth in section 1.501(c)(3)-1(b)(4) of the regulations by virtue of having satisfied the governing instrument provisions of section 508(e). See Rev. Rul. 85-160, page 162.

Part III.—Taxation of Business Income of Certain Exempt Organizations

Section 513.—Unrelated Trade or Business

26 CFR 1.513-1: Definition of unrelated trade or business.
(Also Section 501; 1.501(c)(3)-1.)

Unrelated income; hospital; laboratory services for private patients of staff physicians. The Service will not follow that portion of the decision in *St. Luke's Hospital of Kansas City v. U.S.* that held that a tax-exempt hospital's performance of laboratory testing upon referred specimens from private patients of the hospital's staff physicians is not unrelated trade or business because the services were performed for the convenience of the hospital's members. The Service disgrees with the court's characterization of staff physicians as members of the hospital.

Rev. Rul. 85-109

ISSUE

To what extent will the Internal Revenue Service follow the decision in *St. Luke's Hospital of Kansas City v.*

United States, 494 F. Supp. 85 (W.D. Mo. 1980), holding that a tax-exempt hospital's performance of diagnostic laboratory testing upon specimens of patients of the hospital's staff physicians is not unrelated trade or business under section 513(a) of the Internal Revenue Code?

FACTS

The hospital is exempt from federal income tax under section 501(c)(3) of the Code. Among its activities, it performs diagnostic laboratory testing upon tissue specimens from private office patients of its staff physicians. Staff physicians are those who have the privilege of admitting patients to the hospital and treating them there. Each staff physician collects specimens from the physicians's own private patients at the physician's office. This program is relatively small in size compared to the other activities of the pathology department, and business is not actively solicited through advertising or otherwise. The hospital sends an employee to pick up the specimens and to deliver them to the hospital. The hospital bills the patients of its staff physicians for its services. These patients do not themselves enter the hospital for diagnosis or treatment.

The hospital also is organized to operate a school for teaching residents, interns, medical students, and nurses. The school uses the tissue specimens from private patients of the hospital's staff physicians to assist in training its students. These specimens provide a supply in addition to those taken from the hospital's own patients.

The district court held that the hospital was not engaged in unrelated trade or business within the meaning of section 513 of the Code. The court found that the hospital needed the specimens to carry on its educational activities. As an independent basis for its holding, the court also stated that the hospital's staff physicians were "members" of the hospital within the meaning of section 513(a)(2) and that testing was performed by the hospital primarily for the convenience of the hospital's members.

LAW AND ANALYSIS

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense.

In the general law of charity, the promotion of health is considered to be a charitable purpose. *Restatement (Second) of Trusts*, §§368, 372; *Bogart, Trusts and Trustees*, §374 (rev. 2d ed. 1977); *IV Scott on Trusts* §368, 372 (3rd ed. 1967). See also Rev. Rul. 69-545, 1969-2 C.B. 117.

Section 513(a) of the Code defines the term unrelated trade or business as any trade or business the conduct of which is not substantially related (aside from the need of an organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of the purposes or functions constituting the basis for its exemption under section 501. However, section 513(a)(2) further states that such term does not include any trade or business which is carried on by an organization described in section 501(c)(3) primarily for the convenience of its members, officers, patients, or employees. The patients of the hospital's staff physicians are not patients of the hospital. See Rev. Rul. 68-376, 1968-2 C.B. 246, and Rev. Rul. 85-110, this page, this Bulletin.

It is the position of the Service that the hospital's staff physicians are neither "members" nor "employees" of the hospital in their capacities as private practitioners of medicine. By providing laboratory testing services on tissue specimens referred by its staff physicians in their private capacities, the hospital is not carrying on an activity primarily for the convenience of its members, officers, or employees within the meaning of section 513(a)(2) of the Code.

However, because the facts show that the services provide a supply of specimens needed in the hospital's teaching program, they are substantially related to the exempt purposes of the hospital.

HOLDING

The Internal Revenue Service will follow that part of the decision in *St. Luke's Hospital of Kansas City v. United States*, 494 F. Supp. 85 (W.D. Mo. 1980), holding that a teaching hospital which conducted nonpatient laboratory testing on specimens needed for the conduct of its teaching activities was not engaged in an unrelated trade or business where the outside testing services contributed importantly and substantially to the hospital's teaching program. On the other hand, the Service will not follow that portion of the decision in the *St. Luke's Hospital* case holding that a tax-exempt hospital's performance of laboratory testing upon specimens obtained from private office patients of the hospital's staff physicians who are not patients of the hospital is not unrelated trade or business because the activity is performed primarily for the convenience of its members within the meaning of section 513(a)(2) of the Code.

See Rev. Rul. 85-110 for a discussion of the circumstances under which the provision by a nonteaching hospital of such laboratory services to nonpatients of the hospital will be considered related or unrelated trade or business.

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26 CFR 1.513-1: Definition of unrelated trade or business.
(Also Sections 501, 6001, 6033; 1.501(c)(3)-1, 1.6001-1, 1.6033-2.)

Unrelated income; hospital; laboratory services for private patients of staff physicians. The performance of diagnostic laboratory testing on referred specimens from private patients of hospital staff physicians, by a hospital exempt under section 501(c)(3) of the Code, is unrelated trade or business if such services are otherwise available in the community.

Rev. Rul. 85-110

ISSUE

Under the circumstances described below, does the performance of diagnostic laboratory testing, by a hospital exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code, upon specimens from private office patients of the hospital's staff physicians constitute unrelated trade or business within the meaning of section 513?

FACTS

The hospital is located in a metropolitan area and is organized for the purpose of promoting community health. It is exempt from federal income tax under section 501(c)(3) of the Code and is described in section 170(b)(1)(A)(iii). Among its activities, the hospital performs diagnostic laboratory testing upon specimens from private office patients of its staff physicians and upon specimens from patients of medical clinics not connected with the hospital. These services are performed for a fee. Commercial laboratories that perform testing identical to that performed by the hospital are available in the area.

Specimens from private patients of the hospital's staff physicians are collected by the physician at the physician's office and transmitted to the hospital for analysis. Likewise, specimens from patients of medical clinics are transmitted by the clinics to the hospital. Patients of staff physicians and of the clinics do not themselves enter the hospital for diagnostic testing. Thus, referral of specimens to the commercial laboratories would not hinder or jeopardize the diagnosis or care of patients either of private physicians or of medical clinics. The diagnostic testing does not involve equipment or procedures unique to the hospital. Moreover, the commercial laboratories are sufficiently close by so that testing services can be provided on a timely basis.

LAW

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense.

In the general law of charity, the promotion of health is considered to be a charitable purpose. *Restatement (Second) of Trusts*, §368, 372; *Bogert, Trusts and Trustees*, §374 (rev. 2d ed. 1977); *IV Scott on Trusts* §368, 372 (3rd ed. 1967). See also Rev. Rul. 69-545, 1969-2 C.B. 117.

Section 513(a) of the Code defines the term unrelated trade or business as any trade or business the conduct of which is not substantially related (aside from the need of an organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of the purposes or functions constituting the basis for its exemption under section 501. However, section 513(a)(2) further states that such term does not include any trade or business which is carried on by an organization described in section 501(c)(3) primarily for the convenience of its members, officers, patients, or employees.

Rev. Rul. 68-376, 1968-2 C.B. 246, provides six examples of persons considered "patients" of a hospital for purposes of section 513(a)(2) of the Code: 1) a person admitted to the hospital as an inpatient; 2) a person receiving general or emergency diagnostic, therapeutic, or preventive health services from outpatient facilities of a hospital; 3) a person directly referred to the hospital's outpatient facilities by his private physician for specific diagnostic or treatment procedures; 4) a person refilling a prescription written during the course of his treatment as a patient of the hospital; 5) a person receiving medical services as part of a hospital administered home care program; and 6) a person receiving medical care and services in a hospital-affiliated extended care facility.

Rev. Rul. 85-109, page 165, this Bulletin, holds that the Internal Revenue Service will not follow the decision in *St. Lukes Hospital of Kansas City v. United States*, 494 F. Supp. 85 (W.D. Mo. 1980), to the extent that it holds that a tax-exempt hospital's performance of diagnostic laboratory testing upon specimens of patients of the hospital's staff physicians is not unrelated trade or business because the activity is performed primarily for the convenience of the members of the hospital under section 513(a)(2) of the Code.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "related" to an organization's exempt purposes, in the relevant sense, only where the conduct of the business activities has a causal relationship to the achievement of its exempt purposes (other than through the production of income); and that it is "substantially related," for purposes of section 513 of the Code, only if the causal relationship is a substantial one. Thus, the conduct of trade or business is substantially related to the purposes for which exemption is granted only if the performance of the service provided in such trade or business contributes importantly to the accomplishment of those purposes. Whether an organization's business activities contribute importantly to the accomplishment of its exempt purposes depends in each case upon the facts and circumstances involved.

Section 1.513-1(b) of the regulations provides that for purposes of section 513 the term "trade or business" generally includes any activity carried on for the production of income from the performance of services. Section 513(c) of the Code provides that an activity does not lose its identity as a trade or business merely because it is carried on within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. In Rev. Rul. 68-374, 1968-2 C.B. 242, *Situation 1*, a hospital pharmacy selling pharmaceuticals to the general public was held to be engaged in a trade or business unrelated to the hospital's exempt purposes. No sustantial causal relationship was found between the achievement of the hospital's exempt purposes and the sale of pharmaceuticals to members of the general public who did not otherwise avail themselves of the hospital's medical and diagnostic facilities. Such sales were also found not to be primarily for the convenience of patients of the hospital within the meaning of section 513(a)(2) of the Code. See also *Carle Foundation v. United States*, 611 F.2d 1192 (7th Cir. 1979).

ANALYSIS

The hospital receives gross income from its diagnostic laboratory testing upon specimens from members of the public who do not otherwise avail themselves of the hospital's medical or diagnostic facilities. This activity does not lose its identity as a trade or business merely because the hospital also provides medical and diagnostic services to its own patients in furtherance of its exempt purposes or for the convenience of its patients within the meaning of section 513(a)(2) of the Code. See also section 513(a) of the Code and section 1.513-1(b) of the reg-

ulations. Moreover, there is no substantial causal relationship between the achievement of the hospital's exempt purposes and the provision of such testing to nonpatients. See Rev. Rul. 68-374, *Situation 1*. Also see *Carle Foundation v. United States*.

Further, the hospital's provision of diagnostic laboratory testing services on specimens from persons who are not its patients is not an activity carried on primarily for the convenience of its patients within the meaning of section 513(a)(2) of the Code. The private office patients of the hospital's staff physicians are not the hospital's own patients; likewise, the patients of medical clinics unrelated to the hospital are not patients of the hospital. To determine which persons are "patients" of a hospital for purposes of section 513(a)(2), see Rev. Rul. 68-376.

In addition, because the physicians are not "members" of the hospital, the activity is not that one that is carried on primarily for the convenience of members of the hospital for purposes of section 513(a)(2). See Rev. Rul. 85-109. Even if the staff physicians were characterized as members of the hospital, the facts indicate that the convenience to them is in their capacity as private physicians rather than in their capacity as members of the hospital.

Although the general rule is that the providing of diagnostic laboratory testing services to nonpatients constitutes unrelated trade or business for a tax-exempt hospital, unique circumstances may exist whereby such services may further the exempt function of the hospital. For example, emergency laboratory diagnosis of blood samples from nonpatient drug overdose or poisoning victims in order to identify specific toxic agents is a necessary community service the absence of which would hinder or jeopardize the medical care of patients of other health care institutions lacking such diagnostic facilities. If referral of these specimens to other locations would be detrimental to the health of hospital nonpatients, a hospital may provide such emergency services in furtherance of its exempt function of promoting community health. Similarly, if other laboratories are not available within a reasonable distance from the area served by the hospital or are clearly unable or inadequate to conduct tests needed by hospital nonpatients, a hospital's testing services may further its exempt function of promoting community health. Whether such unique circumstances exist will be decided by the Internal Revenue Service on a case-by-case basis.

HOLDING

Under the circumstances described above, the performance of diagnostic laboratory testing, otherwise available in the community, by a hospital exempt from federal income tax under section 501(c)(3) of the Code, upon specimens from private office patients of the hospital's staff physicians constitutes an unrelated trade or business within the meaning of section 513.

RECORD KEEPING REQUIREMENTS

Under sections 6001 and 6033 of the Code and the regulations thereunder, a hospital providing diagnostic laboratory services on specimens of nonpatients of the hospital in the manner described above is required to keep records by patient and nonpatient classification in order to establish the portion of income subject to unrelated trade or business income tax under section 511.

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26 CFR 1.513-3: Qualified convention and trade show activity.
(Also Section 501; 1.501(c)(5)-1, 1.501(c)(6)-1.)

Unrelated income; convention display space rental; trade show selling activity. Certain revenue rulings that hold that income from the rental of booth space at a show or convention is unrelated business taxable income are revoked. Certain rulings that imply that selling activity at a trade show would result in unrelated trade or business are obsoleted. Rev. Ruls. 75-517, 75-518, 75-519 and 75-520 revoked. Rev. Ruls. 67-219 and 75-516 obsoleted.

Rev. Rul. 85-123

PURPOSE

The purpose of this revenue ruling is to revoke Rev. Ruls. 75-517, 75-518, 75-519 and 75-520, 1975-2 C.B. 222-226 for taxable years beginning after October 4, 1976, because they are inconsistent with section 513(d) of the Internal Revenue Code and the regulations thereunder relating to the treatment of income from qualified convention and trade show activities. This revenue ruling also obsoletes Rev. Rul. 67-219, 1967-2 C.B. 210, and Rev. Rul. 75-516, 1975-2 C.B. 221 for taxable years beginning after October 4, 1976, because those ruling positions are covered in the regulations under section 513(d).

BACKGROUND AND LAW

Section 513(d) was added to the Code by section 1305 of the Tax Reform Act of 1976, 1976-3 C.B. (Vol. 1), 192. It excludes from the computation of unrelated business taxable income amounts received from certain convention and trade show activities. The legislation was prompted by dissatisfaction with revenue rulings that held income from trade shows where selling or order-taking is permitted resulted in unrelated business taxable income. These amendments regarding qualified convention and trade show activities are effective for taxable years beginning after October 4, 1976.

Rev. Rul. 67-219 describes certain trade shows conducted by organizations described in section 501(c)(6) of the Code. The trade shows described are those commonly conducted by associations in which members of an industry, and sometimes members of related industries, join in an exhibition of the products and services of their industries or lines of businesses. Their object is the promotion and stimulation of interest in, and demand for, the industries' products and services in general rather than the operation of a facility for making sales to persons attending the shows. While representatives of exhibitors are present to explain the products and services, they do not sell or take orders. Rev. Rul. 67-219 holds that income derived from the activities involved in presenting the show is from related trade or business and is not subject to the tax imposed by section 511.

Rev. Rul. 75-516 describes a membership organization exempt under section 501(c)(6) of the Code that derives income from the rental of display space at the organization's convention. The display space is made available to exhibitors to exhibit and demonstrate products and services used by the members in their businesses. The exhibits

are solicited on the basis of their potential informational value and on the understanding that exhibits would not be oriented to order-taking or selling. There is a "no-sales" clause in the contract with exhibitors and the organization vigorously enforces the clause to prevent selling and order-taking from occurring in the display area or within the convention facility. Rev. Rul. 75-516 holds that income derived from the rental of this space does not constitute unrelated business taxable income.

Rev. Rul. 75-517 describes an organization exempt under section 501(c)(6) of the Code that conducts a convention where its members participate in meetings concerning the general improvements and technical advances made in their industry. As part of the convention the organization conducts a display show and derives income from the rental of space to exhibitors who exhibit and demonstrate products and services used by the members in their businesses. The organization's rental contracts are silent on whether selling or order-taking is permissible at the show. However, the organization's promotional materials encourage selling and order-taking by emphasizing the convenience and economy of purchasing needed products and services at the convention facility. Rev. Rul. 75-517 holds that the rental of display space constitutes unrelated business taxable income because the facts indicate that the organization is regularly providing a sales facility.

Rev. Rul. 75-518 describes an organization exempt under section 501(c)(5) of the Code that derives income from the rental of display space at the organization's convention under circumstances similar to those described in Rev. Rul. 75-516 except that the "no-sales" contracts are not enforced. Rev. Rul. 75-518 holds that such income is derived from unrelated trade or business.

Rev. Rul. 75-519 describes an organization exempt under section 501(c)(6) of the Code that derives income from the rental of display space at its convention under circumstances similar to those described in Rev. Rul. 75-517 except that sales are specifically permitted within the space assigned. Rev. Rul. 75-519 holds that such income is from unrelated trade or business.

Rev. Rul. 75-520 describes an organization exempt under section 501(c)(6) of the Code that derives income from rental of display space at its trade show under contracts that permit sales as well as contracts that prohibit sales altogether. Rev. Rul. 75-520 holds that rental income derived from the contracts with the "no-sales" clauses is income from related trade or business. However, the income from the contracts permitting selling is unrelated business taxable income because providing a sales facility does not contribute importantly to the organization's exempt purposes.

Section 513(a) of the Code defines unrelated trade or business as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by the organization of its exempt purposes.

Section 513(d) of the Code states that the term unrelated trade or business does not include qualified convention and trade show activities of a qualifying organization. It defines the term "qualified convention and trade show activity" as a convention and trade show activity carried out by a qualifying organization in conjunction with an international, national, State, regional, or local convention, annual meeting, or show conducted by a qualifying organization if one of the organization's purposes in sponsoring the activity is the promotion and stimulation of interest in, and demand for, the products and services of that industry in general, and the show is designed to achieve such purpose throught the character of the exhibits and the extent of the industry products displayed.

Section 1.513-3(b) of the Income Tax Regulations provides that convention and trade show activities carried on by a qualifying organization in connection with a qualified convention and trade show will not be treated as unrelated trade or business.

A qualifying organization is defined in section 1.513-3(c)(1) of the regulations as an organization described in section 501(c)(5) or (6) of the Code which regularly conducts as one of its substantial exempt purposes a qualified convention or trade show.

Section 1.513-3(c)(4) of the regulations provides that convention and trade show activity means any activity of a kind traditionally carried on at shows.

Sections 1.513-3(c)(2)(ii) and (iii) of the regulations indicate that to be a qualified convention or trade show at least one purpose of the sponsoring organization in conducting the show must be the education of its members or the promotion and stimulation of interest in, and demand for, the products or services of the industry of the members of the qualifying organization, and the show must be designed to achieve either one of those purposes through the character of a significant portion of the exhibits or the character of conferences and seminars held at a convention or meeting.

Section 1.513-3(d) of the regulations states that the rental of display space to exhibitors (including exhibitors who are suppliers) at a qualified convention and trade show will not be considered unrelated trade or business even though the exhibitors who rent the space are permitted to sell or solicit orders.

HOLDINGS

Based on section 513(d) of the Code and the regulations thereunder, it is clear that under the facts of Rev. Ruls. 75-517, 75-518, 75-519, and 75-520 the rental of display space would no longer result in unrelated trade or business. Since the conclusion under present law is contrary to the conclusions reached in those revenue rulings, they are revoked for taxable years beginning after October 4, 1976.

The conclusions reached in Rev. Rul. 67-219 and Rev. Rul. 75-516 are not inconsistent with section 513(d),m but those revenue rulings imply that had there been selling at the show it could result in the receipt of unrelated business taxable income. Since that implication is no longer correct and since the positions of those revenue rulings are sufficiently covered in the regulations, Rev. Rul. 67-219 and Rev. Rul. 75-516 are obsoleted for taxable years beginning after October 4, 1976.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 67-219 and Rev. Rul. 75-516 are obsoleted for taxable years beginning after October 4, 1976.

Rev. Rul. 75-517, Rev. Rul. 75-518, Rev. Rul. 75-519, and Rev. Rul.

75-520 are revoked for taxable years beginning after October 4, 1976.

Rev. Rul. 58-224, 1958-1 C.B. 242, and Rev. Rul. 78-240, 1978-1 C.B. 170, are not affected by section 513(d) of the Code, section 1.513-3 of the regulations, or this revenue ruling and remain in full force and effect.

Part VI.—Political Organizations

Section 527.—Political Organizations

26 CFR 1.527-1: Political organizations: generally.

T.D. 8041

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, SUBCHAPTER H, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Designation of Principal Campaign Committee

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the designation of a principal campaign committee by a candidate for Congress. Changes to the applicable tax law were made by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256] and the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. These regulations provide candidates for Congress and their principal campaign committees with the guidance needed to comply with these Acts.

DATES: The amendments to the regulations are effective for taxable years beginning after December 31, 1981.

FOR FURTHER INFORMATION CONTACT: Susan Thompson Baker of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3294).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On April 20, 1983, the FEDERAL REGISTER published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 527 of the Internal Revenue Code of 1954 (48 FR 16911) [LR-243-81, 1983-1 C.B. 1013]. The amendments were proposed to conform the regulations to section 128 of the Economic Recovery Tax Act of 1981 (95 Stat. 172, 203). No written comments responding to this notice were received, and no public hearing was requested or held. This Treasury decision adopts these amendments as proposed, with certain clarifying changes, and conforms the regulations to a change made by section 722(c) of the Tax Reform Act of 1984 (98 Stat. 973).

EXPLANATION OF PROVISIONS

Section 128 of the Economic Recovery Tax Act of 1981 adds new section 527(h) to the Internal Revenue Code of 1954. That section provides that the political organization taxable income of a "principal campaign committee" of a candidate for Congress shall be taxed at the appropriate corporation rate specified in section 11(b) of the Code rather than at the highest rate specified in that section. The highest corporate rate of tax is the rate of tax applicable to other political organizations. In order to qualify for the more favorable rate of tax, a committee must be designated in writing as a "principal campaign committee" by a candidate for Congress. A copy of this written designation, which may be made on Federal Election Commission Form 2 or equivalent document, must be appended to the Form 1120-POL filed by the principal campaign committee for each taxable year for which the designation is effective. Only a candidate for Congress, and not a candidate for other Federal or State office, may make a designation of a principal campaign committee. A candidate for Congress may have only one designation under 527(h) in effect at any time. If, however, a candidate for Congress has only one campaign committee, no designation is required.

NON-APPLICATION OF EXECUTIVE ORDER 12291

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis therefore is not required.

REGULATORY FLEXIBILITY ACT

Although a notice of proposed rulemaking that solicited public comment was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 did not apply. Accordingly, the final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

PAPERWORK REDUCTION ACT

The collection of information requirements contained in these regulations has been submitted to the Office of Management and Budget (OMB) in accordance with the requirement of Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of this regulation is Susan Thompson Baker of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Service and Treasury Department participated in developing the regulation, both substantively and stylistically.

* * * * *

Adoption of amendments to the regulations

Accordingly, the amendments to 26 CFR Part 1 and Part 602 are adopted as proposed, with certain clarifying changes. The amendments read as follows:

26 CFR Part 1 is amended as follows:

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * Section 1.527-9 also issued under 26 U.S.C. 527(h)(2)(B)(i).

Par. 2. Section 1.527-1 is amended by removing the last sentence and adding a new sentence in its place to read as follows:

§1.527-1 Political organizations; generally.

Section 527 provides that a political organization is considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes. A political organization is subject to tax only to the extent provided in section 527. In general, a political organization is an organization that is organized and operated primarily for an exempt function as defined in §1.527-2(c). Section 527 provides that a political organization is taxed on its political organization taxable income (see §1.527-4) which, in general, does not include the exempt function income (see §1.527-3) of the political organization. Furthermore, section 527 provides that an exempt organization, other than a political organization, may be subject to tax under section 527 when it expends an amount for an exempt function, see §1.527-6. The taxation of newsletter funds is provided under section 527(g) and §1.527-7. A special rule for principal campaign committees is provided under section 527(h) and §1.527-9.

Par. 3. Section 1.527-2 is amended by adding a new paragraph (e) immediately following paragraph (d). New paragraph (e) reads as follows:

§1.527-2 Definitions

* * * * *

(e) *Principal campaign committee.* A "principal campaign committee" is the political committee designated by a candidate for Congress as his or her principal campaign committee for purposes of section 302(e) o the Federal Election Campaign Act of 1971 (2 U.S.C. section 432(e)), as amended, and section 527(h) and §1.527-9.

Par. 4. Section 1.527-8(d) is revised to read as follows:

§1.527-8 Effective date; filling requirements; and miscellaneous provisions.

* * * * *

(d) *Effective date.* Except as provided in paragraph (b)(2) of §1.527-6 and in paragraph (a) of §1.527-9, the regulations under section 527 apply to taxable years beginning after December 31, 1974.

Par. 5. A new §1.527-9 is added immediately following §1.527-8. New §1.527-9 reads as follows:

§1.527-9 Special rule for principal campaign committees.

(a) *In general.* Effective with respect to taxable years beginning after December 31, 1981, the tax imposed by section 527(b) on the political organization taxable income of a principal campaign committee shall be computed by multiplying the political organization taxable income by the appropriate rates of tax specified in section 11(b). The political organization taxable income of a campaign committee not a principal campaign committee is taxed at the highest rate of tax specified in section 11(b). A candidate for Congress may designate one political committee to serve as his or her principal campaign committee for purposes of section 527(h)(1). If a designation is made, it shall be made in accordance with the requirements of paragraph (b) of this section. A candidate for Congress may have only one designation in effect at any time. Under 11 CFR 102.12, no political committee may be designated as the principal campaign committee of more than one candidate for Congress. Further, no political committee that supports or has supported more than one candidate for Congress may be designated as a principal campaign committee. No designation need be made where there is only one political campaign committee with respect to a candidate.

(b) *Manner of designation.* If a candidate for Congress elects to make a designation under section 527(h) and this section, he or she shall designate his or her principal campaign committee by appending a copy of his or her Statement of Candidacy (that is, the Federal Election Commission Form 2 or equivalent statement that the candidate filed with the Federal Election Commission under 11 CFR 101.1(a)), to the Form 1120-POL filed by the principal campaign committee for each taxable year for which the designation is effective. This designation may also be made by appending to the Form 1120-POL a statement containing the following information: The name and address of the candidate for Congress; his or her taxpayer identification number, his or her party affiliation and the office sought; the district and State in which the office is sought; and the name and address of the principal campaign committee. This designation shall be made on or before the due date (as extended) for filing Form 1120-POL. Only a candidate for Congress may make a designation in accordance with this paragraph.

(c) *Manner of revoking designation.* A designation of a principal campaign committee that has been filed in accordance with this section may be revoked only with the consent of the Commissioner. In general, the Commissioner will grant such consent in every case where the candidate for Congress has revoked his or her designation in compliance with the requirements of the Federal Election Commission by filing an amended Statement of Organization or its equivalent pursuant to 11 CFR 102.2(a)(2). In the case of the revocation of the designation of a principal campaign committee by a candidate followed by the designation of another principal campaign committee by such candidate, for purposes of determining the appropriate rate of tax under section 11(b) for a taxable year, the political organization taxable income of the first principal campaign committee shall be treated as that of the subsequent principal campaign committee. In a case where consent to revoke a designation of a principal campaign committee is granted and a new designation is filed, the Commissioner may condition his consent upon the agreement of the candidate for Congress to insure compliance with the preceding sentence.

Par. 6. The authority for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 7. Section 602.101(c) is amended by inserting in the appropriate places in the table "§1.527-9.... 1545-0129".

This Treasury decision is issued under the authority contained in section 527(h)(2)(B)(i) of the Internal Revenue Code of 1954 (95 Stat. 203; 26 U.S.C. 527(h)(2)(B)(i)) and section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved June 17, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 29, 1985, 8:45 a.m., and published in the issue of the Federal Register for July 30, 1985, 50 F.R. 30816)

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26 CFR 1.527-4: Special rules for computation of political organization taxable income. (Also Section 164; 1.164-1.)

Political organizations; computation of taxable income. State income taxes paid by a political organization on its nonexempt function income are deductible in computing its taxable income.

Rev. Rul. 85-115

ISSUE

Are state income taxes paid by a political organization on its nonexempt function income deductible in computing political organization taxable income for federal income tax purposes under section 527 of the Internal Revenue Code?

FACTS

P, a political organization that is exempt from federal income tax under section 527 of the Code and that is located in state *ST*, received nonexempt function income during the taxable year. State *ST* imposed an income tax on *P*'s nonexempt function income for the taxable year, less deductions that were directly connected with the production of the nonexempt function income and with certain modifications not relevant here. For federal income tax purposes under section 527(c) of the Code, *P* proposes to deduct the state income taxes in determining its political organization taxable income for the taxable year in which such taxes are paid.

LAW AND ANALYSIS

Section 164(a)(3) of the Code allows a deduction for state, local, and foreign income taxes that are paid or accrued within the taxable year. Section 164 is contained in chapter one of the Code.

Section 527(a) of the Code provides that political organizations are subject to federal income taxation to the extent provided in section 527. Section 527(b) imposes a tax for each taxable year on the political organization taxable income of every political organization.

Section 527(c)(1) of the Code defines political organization taxable income as an amount equal to the excess (if any) of the gross income for the taxable year (excluding any exempt function income as defined in section 527(c)(3)), over the deductions, allowed by chapter one, that are directly connected with the production of the gross income (excluding exempt function income), computed with certain modifications not relevant here.

Section 1.527-4(c) of the Income Tax Regulations provides that to qualify as deductions in computing political organization taxable income, expenses, depreciation, and similar items must not only qualify as deductions allowed by chapter one of the Code, but must also be directly connected with the production of political organization taxable income, expenses, depreciation, and similar items must not only qualify as deductions allowed by chapter one of the Code, but must also be directly connected with the production of political organization taxable income. To be directly connected with the production of political organization taxable income, an item of deduction must have a proximate and primary relationship to the production of such income and must have been incurred in the production of such income. Deductible items attributable solely to items of political organization taxable income are approximately and primarily related to such income. Whether a deductible item is incurred in the production of political organization taxable income is determined on the basis of all of the facts and circumstances of each case.

State income taxes paid or accrued on nonexempt function income are attributable solely to items of political organization taxable income and, therefore, have a proximate and primary relationship to the production of nonexempt function income. In addition, the liability for state income taxes on nonexempt function income is incurred solely because of the production of such income. Therefore, state income taxes on nonexempt function income are directly connected with the production of such nonexempt function income.

A deduction for state income taxes paid is allowable in determining a political organization's taxable income only if the requirements of both sections 164 and 527 of the Code are met. Although, a deduction generally is allowable under section 164 for state income taxes paid, section 527(c)(1) precludes a political organization from taking a deduction for state income taxes paid that are attributable to exempt function income. Thus, only those state income taxes that are attributable to nonexempt function income may be deducted under section 527.

HOLDING

For federal income tax purposes under section 527(c) of the Code, state income taxes paid by *P* on its nonexempt function income are deductible in computing *P*'s taxable income for the taxable year in which such taxes are paid.

Subchapter G.—Corporations Used to Avoid Income Tax on Shareholders
Part II.—Personal Holding Companies

Section 542. Definition of Personal Holding Company

26 CFR 1.542-1: General rule.

Personal holding companies; domestic corporation wholly owned by nonresident alien; investment income. A domestic corporation, wholly owned by a nonresident alien, that makes investments in U.S. real estate and receives interest income from U.S. sources is subject to the personal holding company tax.

Rev. Rul. 85-140

ISSUE

Is a domestic corporation engaged in investment activities in the United States and wholly owned by a nonresident alien individual subject to the personal holding company tax under the facts described below?

FACTS

M is a domestic corporation wholly owned by *A*, a nonresident alien individual. 90 percent of *M*'s gross income consists of interest from loans to United States individuals and corporations. The remainder of *M*'s gross income is derived from buying, selling, and leasing U.S. real property. In 1983, *M*'s entire gross income consisted of rents and interest received from sources within the United States. *M* is not a lending or a finance com-

ıy for purposes of section 542(c)(6) the Internal Revenue Code.

.W AND ANALYSIS

Section 541 of the Code imposes, in lition to all other taxes imposed by apter 1 of the Code, a tax on every rsonal holding company equal to 50 rcent of its undistributed personal lding company income.

Section 542(a) of the Code provides t the term personal holding company eans any corporation (other than a rporation described in section 542(c))

(1) At least 60 percent of its adjusted linary gross income for the taxable ar is personal holding company in- me, and

(2) At any time during the last half the taxable year more than 50 per- nt in value of its outstanding stock is ned, directly or indirectly, by or for t more than 5 individuals.

Section 543(a)(1) of the Code pro- les that the term personal holding mpany income includes interest. Sec- n 543(a)(2) of the Code provides that term personal holding company in- me includes rents, under certain cumstances.

Section 542(c)(7) excepts from the rsonal holding company definition a reign corporation (other than a corpo- ion which has income to which sec- n 543(a)(7) applies for the taxable ar), if all of its stock outstanding ring the last half of the taxable year owned directly or indirectly by non- sident alien individuals.

Section 104(h) of The Foreign Inves- rs Tax Act of 1966, Pub. L. 89-809, 66-2 C.B. 656, 675, amended sec- n 542(c)(7) of the Code. The under- ng legislative history to the provision veals that Congress had concluded at there was no avoidance of the indi- dual income tax when nonresident al- ns formed a foreign corporation to ake investments that would yield ssive income such as dividends and erest. Instead, the sourcing rules of ction 861 would determine whether withholding tax described in sec- ns 881 and 882 would be applicable the foreign corporation and its share- lders. See H.R. Rep. No. 1450, 89th ng., 2d Sess. 30-31 (1966), 1966-2 B. 965, 988; S. Rep. No. 1707, 89th ng, 2d Sess. 36-37, 1966-2 C.B. 1055, 1084-1085.

However, Congress did not except from the definition of personal holding company a domestic corporation wholly owned by nonresident alien individuals. Thus, *M* does not qualify for the exception to personal holding company status contained in section 542(c)(7). In addition, *M* does not qualify for any of the other exceptions to personal holding status set forth in section 542(c).

HOLDING

M is subject to the personal holding company tax because it meets the income and stock ownership requirements specified in section 542(a) of the Code and because it does not qualify for an exception under section 542(c).

Subchapter H.—Banking Institutions
Part I.—Rules of General Application to Banking Institutions

Section 585.—Reserve for Losses on Loans of Banks

26 CFR 1.585-1: Reserve for losses on loans of banks.

An adjustment under section 481(a) of the Code is required when there is an integration under section 381(c)(4) of the bad debt reserve of a thrift institution, computed under section 593, into a reserve of an acquiring commercial bank, computed under section 585, because such action results in a change in method of accounting. See Rev. Rul. 85-171, page 148.

Part II.—Mutual Savings Banks, etc.

Section 593.—Reserve for Losses on Loans

26 CFR 1.593-1: Additions to reserve for bad debts.

An adjustment under section 481(a) of the Code is required when there is an integration under section 381(c)(4) of the bad debt reserve of a thrift institution, computed under section 593, into a reserve of an acquiring commercial bank, computed under section 585, because such action results in a change in method of accounting. See Rev. Rul. 85-171, page 148.

Subchapter I.—Natural Resources
Part I.—Deductions

Section 613.—Percentage Depletion

26 CFR 1.613-4: Gross income from the property in the case of minerals other than oil and gas.

Percentage depletion; china clay; shipping grade and form. The term "shipping grade and form" is to be determined on the basis of mining processes applied by the individual taxpayer to bring the quality or size of its mineral to the stage or stages at which the taxpayer ships its mineral to its customers or applies nonmining processes. Rev. Rul. 83-100 revoked.

Rev. Rul. 85-192

The purpose of this revenue ruling is to revoke Rev. Rul. 83-100, 1983-2 C.B. 101. Rev. Rul. 83-100 holds that fine pulverization and air separation of china clay are not mining processes under section 613(c)(4)(C) of the Internal Revenue Code when a substantial portion of the china clay mined by nonintegrated miners in the general geographic area of the taxpayer's mine is sold and shipped to customers without either fine pulverization or air separation. This conclusion was based upon a determination that the china clay mined by the taxpayer is in shipping grade and form before fine pulverization and air separation based upon industry practice rather than on the taxpayer's operation.

Section 1.613-4(f)(3) of the Income Tax Regulations discusses processes recognized as mining processes under section 613(c)(4)(C) of the Code. Section 1.613-4(f)(3)(iii) of the regulations states that to "bring to shipping grade and form" means to bring (by the application of mining processes at the mine or concentration plant) the quality or size of a mineral to the size or stages at which the mineral is shipped to a customer or used in a nonmining process (as defined in paragraph (g) of this section) by the taxpayer.

The term "shipping grade and form" is to be determined on the basis of mining processes applied by the individual taxpayer to bring the quality or size of its mineral to the stage or stages at which the taxpayer ships its mineral to its customers or applies nonmining processes. Rev. Rul. 83-100 is revoked.

Section 616.—Development Expenditures

26 CFR 1.616-1: Development expenditures.

Whether an investor is at risk for a note that may be satisfied by transferring to the creditor a percentage of the property derived from the mining activity. See Rev. Rul. 85-113, page 150.

Subchapter J.—Estates, Trusts, Beneficiaries and Decedents
Part I—Estates, Trusts, and Beneficiaries
Subpart A.—General Rules for Taxation of Estates and Trusts

Section 643.—Definitions Applicable to Subparts A, B, C, and D

26 CFR 1.643(a)-3: Capital gains and losses.

Whether any portion of a capital gain realized by a trust that is allocated to trust income under state law is deductible by the trust in the taxable year the gain is realized. See Rev. Rul. 85-116, below.

Subpart B.—Trusts Which Distribute Current Income Only

Section 651.—Deduction for Trusts Distributing Current Income Only

26 CFR 1.651(a)-1: Simple trusts; deduction for distributions; in general.
(Also Sections 643, 652; 1.643(a)-3, 1.652(a)-1.)

Trust; underproductive property. Where state law treats stock held by a simple trust as "underproductive property," the income beneficiary is entitled to a statutory portion of any capital gain associated with proceeds from the disposition of the stock and that amount is includible in the distributable net income of the trust.

Rev. Rul. 85-116

ISSUE

Under the circumstances below, is any portion of a capital gain realized by a trust that is allocated to trust income under state law deductible by the trust and includible by the income beneficiary of the trust in the taxable year the gain is realized?

FACTS

T is a trust established in 1977 under *A*'s will for the benefit of *A*'s family. The terms of the trust instrument require that all trust income be paid out currently to *A*'s child *B* for life. *A*'s grandchildren are the remaindermen. *T* was funded exclusively with all the shares of *X*, a closely held corporation that *A* founded. In 1979, *X* adopted a plan of liquidation and sold all of its assets. In 1980, the proceeds of the sale in the amount of 390*x* dollars were distributed to *T* in complete liquidation of *X*.

Under the law of state *V* which is applicable to *T*, a portion of the proceeds of any transaction with respect to underproductive property, that is, trust property that has not produced for more than a year an average net annual income of one percent of its cost or value when acquired by the trust, is treated as "delayed income" which, in the absence of trust provisions to the contrary, is allocated to trust income rather than principal. The portion of the proceeds that is treated as delayed income is the difference between the proceeds and the amount which, had it been invested at five percent annually during the time the property was underproductive, would have produced the proceeds, less any income received by the beneficiary during that time. The balance is treated as principal. The trust instrument is silent concerning the allocation of the sale proceeds to trust income or principal.

The trustee of *T* allocated the liquidating distribution from *X* to principal and petitioned the state surrogate's court for approval of that action. *T* made no distribution to any beneficiary in 1980. In 1981, the court ordered that a portion fo the liquidating distribution should be allocated to *T*'s income account as delayed income because the *X* stock was underproductive property. In that year, after appropriately adjusting the books of *T* to reflect the allocation, the trustee made a distribution to *B* in the amount of 91*x* dollars, which was the amount of delayed income ordered by the court to be allocated to *T*'s income account.

Both *T* and *B* file income tax returns on the calendar year basis. On its 1980 fiduciary income tax return, *T* reported a capital gain of 30*x* dollars as a result of the liquidation of *X*. *B* did not include any of the capital gain on *B*'s individual income tax return for 1980 or for 1981.

LAW AND ANALYSIS

Section 651 of the Internal Revenue Code provides that, in the case of any trust the terms of which (1) provide that all of its income is required to be distributed currently, and (2) do not provide that any amounts are to be paid, permanently set aside, or used for the purposes specified in section 642(c) (relating to the deduction for charitable, etc., purposes), there shall be allowed as a deduction in computing the taxable income of the trust the amount of the income for the taxable year which is required to be distributed currently. If the amount of the income required to be distributed currently exceeds the distributable net income of the trust for the taxable year, the deduction shall be limited to the amount of the distributable net income.

Section 652 of the Code provides that the amount of income for the taxable year required to be distributed currently by a trust described in section 651 shall be included in the gross income of the beneficiaries to whom the income is required to be distributed, whether distributed or not. If that amount exceeds the distributable net income of the trust, there shall be included in the gross income of each beneficiary an amount which bears the same ratio to distributable net income as the amount of income required to be distributed to that beneficiary bears to the amount of income required to be distributed to all beneficiaries. The amount which the beneficiary is required to include in gross income is based upon the amount of income of the trust for any taxable year or years of the trust ending within or with the beneficiary's taxable year.

Income received by a trust that is required to be distributed currently to a beneficiary is taxable to the beneficiary in the taxable year of the beneficiary ending within or with the taxable year of the trust in which the income is received, even though the beneficiary receives the income at a later time due to the trustee's erroneous belief that the receipt constituted corpus and not income. *DeBrabant v. Commissioner*, 90 F. 2d 433 (2d Cir. 1937). *See, Polt v. Commissioner*, 233 F. 2d 893 (2d Cir. 1956); *United States v. Higginson*, 238 F. 2d 439 (1st cir. 1956); Rev. Rul. 62-147, 1962-2 C.B. 151.

Section 643(a) of the Code defines distributable net income to mean the taxable income of the trust computed with the modifications set forth in section 643(a)(1) through (7). Section 643(a)(3) provides that gains from the sale or exchange of capital assets are excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year, or (B) paid, permanently set aside, or to be used for the purposes specified in section 642(c).

Section 1.643(a)-3(a)(1) of the Income Tax Regulations provides that gains from the sale or exchange of capital assets are not ordinarily considered as paid, credited or required to be distributed to a beneficiary unless they are (1) allocated to income under the terms of the governing instrument or local law by the fiduciary on its books or by notice to the beneficiary, (2) allocated to corpus and actually distributed to beneficiaries during the taxable year, or (3) utilized (pursuant to the terms of the governing instrument or the practice followed by the fiduciary) in determining the amount which is distributed or required to be distributed.

Section 643(b) of the Code provides that for purposes of subparts A through D of subchapter J of the Code (sections 641 through 668 of the Code), the term "income," when not preceded by the words "taxable," "distributable net," "undistributed net," or "gross," means the amount of income of the trust for the taxable year determined under the terms of the governing instrument and applicable local law.

In the present case, the trust realized a capital gain in 1980 on the liquidation of *X* corporation. Under applicable local law, the law of state *V*, 91*x* dollars of the amount received by *T* in 1980 was treated as income and, therefore, was "income" within the meaning of section 643(b) of the Code. Under the terms of the trust instrument, all trust income was required to be distributed currently to *B*. Accordingly, under section 651, *T* is allowed a deduction in computing its taxable income for 1980 for the amount of income required to be distributed currently to *B*, limited to the distributable net income of *T*. Under section 652, *B* is required to include in gross income for 1980 an amount equal to the amount deductible by the trust under section 651. This is so despite the fact that the 91*x* dollars was not distributed to *B* until 1981. *DeBrabant v. Commissioner*.

To the extent that capital gains are allocated to income, they are included in computing distributable net income for purposes of section 651 of the Code. Section 1.643(a)-3(a)(1) of the regulations. In this case, 91/390 of the proceeds received by *T* is allocated to income under the law of state *V*. Therefore, a proportionate part of the capital gain realized by *T*, 7*x* dollars (91/390 × 30*x* dollars), is considered allocated to income and hence includible in the computation of distributable net income. *See*, example 5 of section 1.643(a)-3(d), showing that where half the proceeds of the sale of stock by a trustee was distributed to a beneficiary, half the capital gain is considered allocable to the beneficiary.

HOLDING

The 91*x* dollars of delayed income constitutes trust income required to be distributed to *B* in 1980. The total amount of trust income required to be distributed to *B* in 1980 is included in *B*'s gross income for that year, and is allowed as a deduction to *T*, to the extent this amount does not exceed *T*'s distributable net income for 1980. *T*'s distributable net income for that year includes 7*x* dollars of the capital gain *T* realized on the liquidation of *X*.

Section 652.—Inclusion of Amounts in Gross Income of Beneficiaries of Trusts Distributing Current Income Only

26 CFR 1.652(a)-1: Simple trusts; inclusions of amounts in income of beneficiaries.

Whether any portion of a capital gain realized by a trust that is allocated to trust income under state law is includible in the beneficiary's gross income in the taxable year the gain is realized. See Rev. Rul. 85-116, page 174.

Subpart E.—Grantors and Others Treated as Substantial Owners

Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners

26 CFR 1.671-3: Attribution or inclusion of income, deductions, and credits against tax. (Also Sections 162, 677; 1.162, 1.677.)

Grantor trust; commodity exchange clearing house. A commodity futures exchange clearing house corporation that funds a trust to protect customers of the exchange from financial loss resulting from the insolvency of any clearing member is the grantor of the trust because the exchange requires that the clearing house assume all legal obligations arising out of any trade cleared. The clearing house cannot deduct contributions to the trust. It can deduct payments made by the trust in satisfaction of the clearing house's legal obligations when paid or incurred.

Rev. Rul. 85-158

ISSUE

Can a commodity futures exchange clearing house corporation that funds a trust for the purpose of protecting customers of the exchange from financial loss due to the insolvency of any of the clearing members be allowed a current deduction for contributions to the trust, under the circumstances described below?

FACTS

A commodity futures exchange regulated by the Commodity Futures Trading Commission provides a marketplace for buying and selling cash commodities and commodity futures contracts. *X*, a corporation established by the exchange and composed of certain exchange members, clears all trades occurring on the exchange at the end of each trading day.

The rules and regulations of the exchange require *X* to gurantee payment when clearing members default on contracts traded on the exchange. To meet this legal obligation, protect investors, and promote public confidence, *X* created an irrevocable trust, *T*, to provide funds to be used solely for the purpose of preventing or mitigating losses of public customers having claims against defaulting clearing members. The trustee of *T* has no beneficial interest in the trust.

The exchange, the clearing corporation, and the trust are calendar year taxpayers. During the first taxable year, the trust received a contribution of 100*x* dollars from *X* and made no payments to satisfy customer claims. On its federal income tax return for the year, *X* treated the contribution of 100*x* dollars as a current deduction.

LAW AND ANALYSIS

Section 677(a) of the Internal Revenue Code provides that a grantor is treated as the owner of any portion of a trust whose income (1) is distributed to the grantor without the approval or consent of any adverse party, or (2) in the discretion of the grantor or a nonadverse party or both, may be distributed to the grantor without the ap-

proval or consent of any adverse party.

Section 1.677(a)-1(d) of the Income Tax Regulations provides, in general, that a grantor is treated as the owner of a portion of a trust whose income (1) is applied in discharge of a legal obligation of the grantor, or (2) in the discretion of the grantor or a nonadverse party or both;, may be applied in discharge of a legal obligation of the grantor.

Section 671 of the Code provides that when the grantor is treated as the owner of any portion of a trust, the grantor's taxable income and credits include those items of the trust's income, deductions, and credits attributable to the portion of the trust that the grantor is treated as owning.

Section 1.671-2(c) of the regulations provides that an item of income, deduction, or credit included in computing a grantor's taxable income and credits is treated as if the grantor (whether or not an individual) had received or paid it directly.

Section 1.671-3(a)(1) of the regulations provides that if the grantor is treated as the owner of an entire trust, the grantor takes into account in computing income tax liability all items of income, deduction, and credit to which the grantor would have been entitled if the trust had not been in existence during the period the grantor is treated as the owner.

Section 1.671-2(e) of the regulations provides that the term "grantor" includes a corporation.

Section 672(a) of the Code defines an "adverse party" as any person having a substantial beneficial interest in a trust that would be adversely affected by the exercise or nonexercise of a power that the party possesses respecting the trust. Section 672(b) defines a "nonadverse party" as any person who is not an adverse party.

Section 162 of the Code allows as a deduction all the ordinary and necessary expenses paid or incurred during the tax year in carrying on any trade or business.

When a taxpayer pays another's debts because of a prior guarantee, the taxpayer guarantor may deduct the amount paid under section 162 of the Code if the taxpayer shows that the payment of the guarantee is an ordinary and necessary business expense. *F.M. Frazier*, T.C.M. 1975-220.

In the present case, because *T's* income and corpus may be used to discharge *X's* legal obligations arising out of the purchase or sale of any trade cleared and the trustee is not an adverse party, *X* is considered to be the owner of the entire trust under section 677(a) of the Code. Under section 671, *X* must include *T's* items of income, deduction and credit in computing its taxable income. *X* is not allowed a deduction at the time of the contribution to the trust. *X* is allowed a deduction under section 162 when liabilities to customers are paid or incurred, depending on the method of accounting used by *X*. See Rev. Rul. 57-390, 1957-2 C.B. 326, which concludes that the method of accounting used by a grantor trust is disregarded and gross income from the trust properties must be determined by the grantor as if the trust had not been created.

HOLDING

The 100*x* dollars contribution by X to *T* is not deductible under section 162 of the Code. *X* must include *T's* items of income, deduction, and credit in computing *X's* taxable income. *X* is allowed to deduct *T's* payments in satisfaction of *X's* legal obligations, when paid or incurred by *T*, depending on the method of accounting used by *X*.

Section 677.—Income for Benefit of Grantor

26 CFR 1.677: Income for benefit of grantor; general rule.

A commodity futures exchange clearing house corporation that funds a trust to protect customers of the exchange from financial loss resulting from the insolvency of any clearing member is considered to be the owner of the trust because the exchange requires that the corporation assume all legal obligations arising out of any trade cleared. See Rev. Rul. 85-158, page 175.

Part II.—Income In Respect of Decedents

Section 692.—Income Taxes Of Members Of Armed Forces On Death

26 CFR 1.692-1: Abatement of income taxes of certain members of the Armed Forces of the United States upon death.

Joint return; employees of the U.S.; death result of terroristic or military action. The proration formula of section 1.692-1(b) of the regulations must be applied in determining the portion of the joint income tax liability forgiven for military and civilian employees of the U.S. who die as a result of wounds or injury suffered after November 17, 1978, outside the U.S. in a terroristic or military action, as defined in section 692(c) of the Code. Rev. Rul. 78-1 amplified.

Rev. Rul. 85-103

Rev. Rul. 78-1, 1978-1 C.B. 199, holds that the proration formula of section 1.692-1(b) of the Income Tax Regulations must be applied, in determining the portion of the joint income tax liability forgiven for an Armed Forces member who died as a result of service in a combat zone, to a joint return filed for an earlier year by the surviving spouse and the executor or administrator after notification of the member's death, whether the return is an original joint return or an amended return filed with respect to a year for which either a joint return was filed or a separate return was filed by the member or the spouse or both.

Pub. L. No. 98-259, 1984-1 C.B. 313, as amended by the Tax Reform Act of 1984, Pub. L. No. 98-369, section 722(g), 98 Stat. 494, 1984-3 C.B. (Vol. 1) 1, 482, enacted section 692(c) of the Internal Revenue Code. Section 692(c)(1) of the Code provides that, in the case of any individual who dies while a military or civilian employee of the United States, if such death occurs as a result of wounds or injury incurred outside the United States while in a terroristic or military action, any tax imposed by subtitle A of the Code (income tax) shall not apply with respect to the taxable year in which falls the date of death and with respect to any prior taxable year in the period beginning with the last taxable year ending before the taxable year in which the wounds or injury were incurred.

Section 692(c)(2) of the Code defines "terroristic or military action" as any terroristic activity directed against the United States or any of its allies and any military action involving the Armed Forces of the United States and resulting from violence or aggression against the United States or any of its allies.

Consistent with the position on proration expressed in Rev. Rul. 78-1 and the subsequent enactment of section 692(c) of the Internal Revenue Code, the position on proration expressed in Rev. Rul. 78-1 is also applicable to military and civilian employees of the United States who die as a result of wounds or injury suffered after November 17, 1978, outside the United States in a terroristic or military action, as defined in section 692(c) of the Code.

EFFECT ON OTHER REVENUE RULING

Rev. Rul. 78-1 is amplified.

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26 CFR 1.692-1: Abatement of income taxes of certain members of the Armed Forces of the United States upon death.

Procedures for having tax forgiven or for claiming refunds of tax for certain military and civilian employees of the United States dying as a result of injuries incurred outside the United States in a terroristic or military action. See Rev. Proc. 85-35, page 433.

Subchapter L.—Insurance Companies
Part III.—Other Insurance Companies

Section 832.—Insurance Company Taxable Income

26 CFR 1.832-5: Deductions.

Capital losses; dispositions to meet normal insurance losses. Losses on capital assets sold or exchanged to meet abnormal insurance losses in excess of capital gains are deductible in the year incurred to the extent of taxable income; to the extent such losses exceed taxable income they become a net capital loss carryback or carryforward. Such losses retain their character when carried back or forward and must first be offset against capital gains in the carryback or carryforward year before being deducted against taxable income.

Rev. Rul. 85-166

ISSUE

How are losses on capital assets sold or exchanged by an insurance company to meet abnormal insurance losses treated for federal income tax purposes when carried back or forward?

FACTS

Taxpayer is an insurance company that is taxable under section 831 of the Internal Revenue Code. Taxpayer uses the cash method of accounting and a calendar year tax period.

During its tax year ending December 31, 1981, the taxpayer sold at a loss stocks it was holding for investment. The taxpayer had no capital gains during 1981. The capital losses resulting from the sales are considered losses on sales to meet abnormal insurance losses under section 832(c)(5) of the Code. Taxpayer's abnormal insurance losses for the year exceeded its taxable income computed without regard to the abnormal insurance losses.

LAW AND ANALYSIS

Section 832(b)(1)(B) of the Code provides that, in the case of an insurance company subject to the tax imposed by section 831, gross income includes gain during the tax year from the sale or disposition of property.

Section 832(c)(5) of the Code allows an insurance company subject to the tax imposed by section 831 a deduction for capital losses to the extent provided in subchapter P (section 1201 and following, relating to capital gains and losses) plus losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. Section 832(c)(5) further provides that in the application of section 1212 for purposes of section 832, the net capital loss for the taxable year is the amount by which losses for that year from sales or exchanges of capital assets exceed the sum of the gains from those sales or exchanges, and the lesser of: (A) the taxable income (computed without regard to gains or losses from sales or exchanges of capital assets), or (B) losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders.

The legislative history of section 207(b)(4)(F) of the 1939 Code, the predecessor of section 822(c)(6) of the Code, indicates that the purpose for enacting the abnormal insurance losses provision was as follows:

> Representations were made that insurance companies other than life frequently had no control over the timing of the sale of their assets, since in years of abnormal insurance losses they were forced to liquidate assets in order to be able to pay losses . . . Consequently losses on assets sold for this purpose might safely be allowed as a deduction from regular income without possibility of abuse . . . A special rule is set forth for the application of the 5-year capital loss carry-over provisions of section 117(e) for the purposes of this section in order to prevent capital losses actually used to reduce net income in any year from again being used in a future year as an offset against capital gains in that year. S. Rep. No. 1631, 77th Cong., 2d Sess. 153 (1942), 1942-2 C.B. 504, 618.

Under section 832(c)(10) of the Code, net operating losses under section 172 may be deducted in computing taxable income of an insurance company subject to the tax imposed by section 831.

Section 1.832-5(a) of the Income Tax Regulations provides that, for purposes of section 172 of the Code, "gross income" means gross income as defined in section 832(b)(1) and the allowable deductions are those allowed by section 832(c) with the exceptions and limitations set forth in section 172(d).

Section 832(d) provides that nothing in section 832 shall permit the same item to be deducted more than once.

In Rev. Rul. 68-60, 1968-1 C.B. 322, the Service considered the application of the alternative tax on capital gains in a situation involving abnormal insurance losses. It was concluded that section 832(c)(5) of the Code does not convert a capital loss into an ordinary loss but, instead, provides a current deduction against taxable income for capital losses that otherwise would be carried forward and treated as a short-term capital loss under section 1212.

As described above, section 832(c)(5) of the Code provides a specific rule for the carryback and carryforward of losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses. This rule, which reduces the net capital loss for a taxable year, was enacted to prevent capital losses which were actually used to reduce taxable income in a given year from being used

again in a carryback or carryforward year. The net capital loss is not reduced either by capital losses which did not qualify as losses on sales to meet abnormal losses because such losses were in excess of the amount of abnormal losses (section 832(c)(5)(B)) or by capital losses which did qualify as losses on sales to meet abnormal losses but which did not reduce taxable income in the year of the loss (section 832(c)(5)(A)).

The allowance of a deduction under section 832(c)(5) of the Code for capital losses on sales to obtain funds to meet abnormal losses could be interpreted as having the effect of creating or increasing a net operating loss in taxable years in which such losses exceed the company's taxable income (computed without regard to gains or losses from sales or exchanges of capital assets). The allowance of a net operating loss carryback or carryforward deduction in addition to the capital loss carryback or carryforward deduction allowed by section 1212 would violate the double deduction prohibition of section 832(d). Thus the net operating loss deduction must be disallowed. To disallow the capital loss carryback or carryforward deduction rather than the net operating loss deduction would render meaningless the section 832(c)(5)(A) limitation, reverse the basic ordering rule of section 835(c)(5) that capital losses must first reduce capital gains for a taxable year before reducing ordinary income for that year, and conflict with the assumption of the legislative history that carryforwards of capital losses on sales to meet abnormal losses would be used in future years against capital gains and the holding of Rev. Rul. 68-60 that section 832(c)(5) does not convert a capital loss into an ordinary loss.

Although losses on sales to meet abnormal insurance losses in excess of taxable income do not create or increase a net operating loss, these losses should not lose their character as abnormal insurance losses when carried back or forward to other taxable years simply because these losses cannot be used against income in the year in which incurred. The special treatment provided for abnormal insurance losses, which would otherwise be treated as capital losses, occurs because of the lack of control over the timing of the sale of the assets. See S. Rep. No. 1631. Thus, although abnormal insurance losses are considered net capital losses in a carryover period, these net capital losses retain their character as abnormal insurance losses in the carryback or carryforward years.

HOLDING

Losses on capital assets sold or exchanged to meet abnormal insurance losses, as defined in section 832(c)(5) of the Code, in excess of capital gains are deductible in the year incurred to the extent of taxable income. Losses on sales to meet abnormal insurance losses in excess of taxable income become a net capital loss carryback or carryforward. Losses on sales to meet abnormal insurance losses retain their character when carried back or forward and must first be offset against capital gains in the carryback or carryforward year before being deducted against taxable income.

Subchapter M.—Regulated Investment Companies and Real Estate Investment Trusts
Part I.—Regulated Investment Companies

Section 851.—Definition of Regulated Investment Company

26 CFR 1.851-2: Limitations.

Regulated investment company; gains from real estate. For purposes of determining whether a corporation will continue to qualify as a regulated investment company under section 851 of the Code, gains from the sale or disposition of real estate are not reduced by losses from the sale or disposition of other property in computing gross income for purpose of section 851(b)(2). Because such gains represent 20 percent of the taxpayer's gross income, the taxpayer does not qualify as a regulated investment company.

Rev. Rul. 85-167

ISSUES

1) For purposes of determining whether a corporation will continue to qualify as a regulated investment company under section 851 of the Internal Revenue Code, are gains from the sale or disposition of property such as real estate reduced by losses from the sale or disposition of other property in computing gross income for purposes of section 851(b)(2)?

2) Does receipt of this gain prevent the taxpayer from qualifying as a regulated investment company under section 851 of the Code?

FACTS

The taxpayer is a management investment company registered under the Investment Company Act of 1940 that elected to be taxed as a regulated investment company under subchapter M (sections 851-855) of the Code in 1980. The taxpayer acquired two real estate properties for its investment business. Subchapter M does not prohibit the ownership of this type of property.

In 1982, the taxpayer sold one real estate property and realized a long-term capital gain of 20x dollars. The taxpayer also sold in 1982 the other real estate property and realized a long-term capital loss of 10x dollars. If the long-term capital gain is included in the taxpayer's gross income for purposes of section 851(b)(2) without taking into consideration the long-term capital loss, the gain would represent 20 percent of the taxpayer's gross income for its 1982 tax year.

LAW AND ANALYSIS

Section 851(b)(2) of the Code provides that a corporation shall not be considered a regulated investment company for any taxable year unless at least 90 percent of its gross income is derived from dividends, interest, payments with respect to securities loans (as defined in section 512(a)(5)), and gains from the sale or disposition of stock or securities.

Under section 61(a)(3) of the Code, gross income includes gains from dealings in property, except as otherwise provided, in subtitle A. Section 1.61-6(a) of the Income Tax Regulations generally defines gain realized on the sale of an item of property as the excess of the amount realized over the unrecovered cost or other basis of the item. The term "gross income" used in section 851(b) has the same meaning as the general definition of gross income contained in section 61.

Section 1.851-2(b)(1) of the regulations provides that in determining the gross income requirements under section 851(b)(2) and (3) of the Code, a loss from the sale or other disposition

of stock or securities does not enter into the computation.

Rev. Rul. 63-118, 1963-1 C.B. 121, holds that for purposes of section 851(b) of the Code the term "gross income" includes gains from the sale or other disposition of stock or securities undiminished by losses from such sales or other dispositions.

Neither the Code nor the regulations allows capital gains from the sale or disposition of property such as real estate to be offset by capital losses in determining gross income for purposes of section 61 of the Code. This general principle is reflected in section 1.851-2(b)(1) of the regulations, wherein it is provided that gains from the sale or disposition of stock or securities are included in gross income undiminished by losses from the sale or disposition of securities. *See also* Rev. Rul. 63-118.

The gain realized from the sale of real estate represents 20 percent of the taxpayer's gross income. The gain cannot be considered gross income derived from dividends, interest, or gains from the sale or disposition of stock or securities. To qualify as a regulated investment company under section 851 of the Code, section 851(b)(2) requires that 90 percent of a taxpayer's gross income must be derived from dividends, interest, or gains from the sale or disposition of stock or securities.

HOLDINGS

1) For purposes of determining whether a corporation will continue to qualify as a regulated investment company under section 851 of the Code, gains from the sale or disposition of property such as real estate are not reduced by losses from the sale or disposition of other property in computing gross income under section 851(b)(2).

2) The receipt of these gains, 20 percent of the taxpayer's gross income, prevents the taxpayer from qualifying as a regulated investment company under section 851 of the Code in 1982.

Subchapter N.—Tax Based on Income from Sources Within or Without the United States
Part III.—Income From Sources Without the United States
Subpart D.—Possessions of the United States

Section 936.—Puerto Rico and Possession Tax Credit

26 CFR 1.936-1: Election of possessions corporation credit
(Also Sections 368, 381; 1.368-1, 1.381(a)-1.)

Possession tax credit; Puerto Rico; election. In a statutory merger between two domestic corporations, each of which had previously elected to be treated as a possessions corporation under section 936 of the Code, the surviving corporation's section 936 election will not be terminated.

Rev. Rul. 85-124

ISSUE

As a result of a statutory merger between two domestic corporations, each of which had previously elected to be treated as a possessions corporation under section 936 of the Internal Revenue Code, is the surviving corporation's section 936 election terminated?

FACTS

P, a domestic corporation, together with its subsidiaries, manufactures and markets electronic equipment for domestic and foreign markets. *P* owns all of the stock of *S-1* and *S-2*, both of which are domestic corporations organized under the laws of State *A* that have each properly elected to be treated as a possessions corporation under section 936 of the Code. *S-1* and *S-2* manufacture different product lines in Puerto Rico. For valid business reasons, *P* desires to streamline its Puerto Rican operations. To accomplish this purpose, *S-2* will be merged into *S-1* under the law of State *A* in a transaction that will qualify as a reorganization under section 368(a)(1)(A). *P* will exchange all of its stock in *S-2* for shares of *S-1* on a one-for-one share basis. *S-1* will be the surviving corporation. *S-1* will be engaged in substantially the same business in Puerto Rico, formerly conducted by *S-1* and *S-2*. Neither *S-1* nor *S-2* made an election under section 936(h) prior to the merger.

LAW AND ANALYSIS

Section 936(a) of the Code generally provides that if a domestic corporation makes an election under section 936(a) and, if the conditions of section 936(a)(2) are satisfied, the corporation is allowed as a credit against its income tax an amount equal to the portion of the tax that is attributable to specified possession-source income.

In Rev. Rul. 69-566, 1969-2 C.B. 165, an electing small business corporation, as defined in section 1371(b) of the Code (before its amendment in 1982), acquired the assets of another (non-electing) corporation in a reorganization qualifying under section 368(a)(1)(A). The electing corporation was the sole surviving corporation. The Service held the reorganization in and of itself did not terminate the electing corporation's election under section 1372 (before its amendment in 1982).

Compare Rev. Rul. 80-168, 1980-1 C.B. 178, which holds that a change in the place of incorporation effected pursuant to a statutory merger and qualifying as a reorganization under section 368(a)(1)(F) of the Code does not terminate the election to be treated as a possessions corporation under section 936. See also Rev. Rul. 64-250, 1964-2 C.B. 333.

In the present situation, *S-1* made an election under section 936(a) of the Code prior to its statutory merger with *S-2* (which also had made a section 936 election). *S-1* will be engaged in the same business in Puerto Rico and will satisfy the conditions of section 936(a)(2) after the reorganization.

HOLDING

The statutory merger qualifying as a reorganization under section 368(a)(1)(A) of the Code does not terminate *S-1*'s election to be treated as a possessions corporation pursuant to section 936.

Subpart I.—Admissibility of Documentation Maintained in Foreign Countries
Part IV.—Domestic International Sales Corporations
Subpart A.—Treatment of Qualifying Corporations

Section 994.—Inter-Company Pricing Rules

26 CFR 1.994-1: Inter-company pricing rules for DISCs.

Procedures under which certain adjustments of accounts and reclassification of distributions will be made in cases in which intercompany prices paid by a DISC to its related supplier or commissions paid by a related supplier to a DISC have been redetermined by the Service. See Rev. Proc. 85-45, page 505.

Subchapter O.—Gain or Loss on Disposition of Property
Part I.—Determination of Amount of and Recognition of Gain or Loss

Section 1001.—Determination of Amount of and Recognition of Gain or Loss

Whether a parent corporation that is a dealer in personal property may treat the extension of credit by its subsidiary, a national bank, to the parent corporation's customers as equivalent to the parent corporation selling on the installment basis to its customers and then selling the installment obligations in a deferred intercompany transaction to its subsidiary. See Rev. Rul. 85-133, page 192.

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26 CFR 1.1001-1: Computation of gain or loss. (Also Section 165; 1.165-1)

Losses; recognition; concurrent transfers of mortgage loan portfolios. Losses are not realized when three unrelated savings and loan associations enter into a series of concurrent transactions in which each party "sells" and "purchases," among themselves, a portion of their respective mortgage loan portfolios. Rev. Rul. 81-204 amplified.

Rev. Rul. 85-125

ISSUE

Do the taxpayers realize losses from concurrent transfers of a portion of their respective mortgage loan portfolios, under the circumstances described below?

FACTS

In 1980, *X*, *Y*, and *Z*, three unrelated federally chartered savings and loan associations entered into a series of concurrent transactions in which each party "sold" and "purchased", among themselves, a portion of their respective mortage loan portfolios (the "mortgage pools").

The mortgage pools "sold" and "purchased" by *X*, *Y*, and *Z* consisted of single-family residential, conventional mortgages with the same contract interest rates and the same stated terms to maturity. The average remaining lives as well as the aggregate unamortized principal balances and the aggregate fair market values of the mortgages in each of the mortgage pools were essentially the same at the time of each "sale" and "purchase". The underlying mortgages that made up the pools involved different mortgagors and different collateral, and some of the mortgages were transferred for mortgages located in other parts of the city, county, or state.

In these transactions, *X*, *Y*, and *Z* each transferred a mortgage pool of low-interest bearing mortgages for a substantially similar mortgage pool and paid and received substantially the same amount of cash with the result that there was no change in position. The cash received equalled the fair market value of the mortgage pools, which had substantially declined in value due to the increase in interest rates.

For federal income tax purposes, *X*, *Y*, and *Z* each claimed a loss deduction in 1980 in the amount of the difference between the cash proceeds received and the adjusted basis of its transferred mortgage pool. For financial reporting purposes, the appropriate regulatory agency did not require *X*, *Y*, and *Z* to record a loss.

LAW AND ANALYSIS

Section 1001(a) of the Internal Revenue Code provides that the gain from the sale or other disposition of property shall be the excess of the amount realized there from over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

Section 1.1001-1(a) of the Income Tax Regulations provides that the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained.

Section 165(a) of the Code provides, generally, that there shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

Section 1.165-1(b) of the regulations provides that to be allowable as a deduction under section 165(a), a loss must be evidenced by closed and completed transactions, fixed by identifiable events, and, except as otherwise provided in section 165(h) and section 1.65-1, relating to disaster losses, actually sustained during the taxable year. Only a bona fide loss is allowable. Substance and not mere form shall govern in determining a deductible loss.

Rev. Rul. 81-204, 1981-2 C.B. 157, holds that the exchange of mortgage pools among three unrelated savings and loan associations did not result in a loss because the requirements of section 1.1001-1(a) of the regulations have not been met. The mortgage loan portfolios ("pools") exchanged did not differ materially either in kind or extent. Instead, the mortgage pools exchanged constituted mass or indivisible assets that averaged out the unique characteristics and risks inherent in each constituent mortgage. The existence of different mortgagors and different collateral in the mortgages that made up the mortgage pools did not prevent the agregation of the mortgages into a mass or indivisible asset.

In this situation, as in Rev. Rul. 81-204, the mortgage pools "sold" and "purchased" by *X*, *Y*, and *Z* possessed sufficient economic correspondence to each other that the mortgage pools cannot be considered as differing materially either in kind or extent from each other, despite the differences in the identities of the individual mortgagors and in the underlying collateral. All three pools consisted of single family residential, conventional mortgages with the same contract interest rate and the same stated terms to maturity. The average remaining lives as well as the aggregate unamortized balances and the aggregate fair market values of the mortgages in each of the three mortgage pools "sold" and "purchased" were substantially the same at the time of the transfers.

The fact that the transactions were structured as "sales" and "purchases" as opposed to "mortgage swap" transactions within the factual setting of Rev. Rul. 81-204 does not alter this conclusion. Rather than separate and distinct transactions, the concurrent "sales" and "purchases" represent component parts of an integrated transaction in which the first step was to "sell" the mortgage pool and the second step was to "acquire" another matched mortgage pool. Thus, after the concurrent "sales" and "purchases" of the mortgage pools, *X*, *Y*, and *Z* were in substantially the same economic position as before these

transactions. The transfers of the mortgages and cash did not have independent adequacy. Each part of the transaction was dependent on every other part, and *X*, *Y*, and *Z* were in the same economic position before and after the transaction.

While each taxpayer may have had a business purpose for securing a different portfolio of mortgages, the facts indicate that the "sale" and "purchase" of mortgage pools had no economic purpose or utility apart from the anticipated tax consequences. In each case, the transfer was so hedged, in terms of economic reality, that it cannot be considered to be the closing out of a losing venture. An actual loss is not realized for tax purposes unless when the entire transaction is concluded, the taxpayer has sustained the loss claimed. *See Shoenberg* v. *Commission*, 77 F.2d 446 (8th Cir. 1935).

HOLDING

Under the circumstances described above, the taxpayers do not realize losses from concurrent transfers of a portion of their respective mortgage loan portfolios.

EFFECT ON OTHER DOCUMENTS

This revenue ruling amplifies Rev. Rul. 81-204 by extending the rationale and holding to a series of concurrent "sales" and "purchases" of mortgage pools by three unrelated savings and loan associations.

Part II.—Basis Rules of General Application

Section 1016.—Adjustments to Basis

26 CFR 1.1016-3: Exhaustion, wear and tear, obsolescence, amortization, and depletion for periods since February 28, 1913.

Automobiles used in a trade or business by employees or self-employed individuals. See Rev. Proc. 85-49, page 716.

26 CFR 1.1016-5: Miscellaneous adjustments to basis.

Reduction of basis in the case of an automobile on which gas guzzler tax was imposed. See T.D. 8036, page 208.

Section 1017.—Discharge Of Indebtedness

26 CFR 1.1017-2: Adjusted basis; discharge of indebtedness; special cases.

Conditions under which the Service will issue an advance ruling and enter into a closing agreement permitting a variation from the general rule of section 1.1017-1 of the regulations relating to the adjustment to basis of depreciable property resulting from a discharge of indebtedness under section 108 of the Code. See Rev. Proc. 85-44, page 504.

Part III.—Common Nontaxable Exchanges

Section 1031.—Exchange of Property Held for Productive Use or Investment

26 CFR 1.1031(a)-1: Property held for productive use in trade or business or for investment. (Also Sections 1033, 1071; 1.1033(a)-1, 1.1071-1.)

Sales or exchanges; like-kind; broadcast assets. The exchange of assets of two television stations for the assets in another television station qualifies for nonrecognition of gain or loss treatment as an exchange of like-kind property under section 1031(a) of the Code.

Rev. Rul. 85-135

ISSUE

Under the circumstances described below, will the corporate taxpayers' transfer and receipt of property constitute an exchange of property held for productive use in trade or business solely for property of a like kind to be held for productive use in trade or business pursuant to section 1031(a) of the Internal Revenue Code? Also, may Y treat the exchange of broadcast assets as an involuntary conversion under sections 1071 and 1033 or, alternatively, under section 1031?

FACTS

X corporation is engaged in the business of broadcasting, cablevision, and newspaper publishing. *X*'s television stations include *K* and *L*, both of which have been owned and operated by *X* for more than five years. *X* is in compliance with the Federal Communications Commission's (F.C.C.) policies concerning the cross-ownership of television stations and newspapers in the same community.

Y corporation, unrelated to *X*, owns and operates television station *H* and also owns *J*, a newspaper serving the same community as *H*. *H* and *J* are properties held for productive use in trade or business or for investment. Y has owned *J* for more than five years. The F.C.C. issued to *Y* the Tax Certificate described in section 1071 of the Code certifying that *Y*'s transfer of the assets of *H* is a sale or exchange necessary to effectuate the F.C.C.'s policies concerning the cross-ownership of television stations and newspapers whose areas of operation are wholly or partially overlapping.

In order to diversify their media markets, and consistent with the F.C.C.'s cross-ownership policies, *X* exchanged the assets of *K* and *L* in return for *Y*'s transfer of the assets of *H*. The property exchanged did not include stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest or other securities or evidences of indebtedness or interest. The exchange was contingent upon the F.C.C.'s grant of its consent to the assignment of the broadcast licenses of *K*, *L*, and *H*.

LAW AND ANALYSIS

Section 1031(a) of the Code provides that no gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

Section 1071 of the Code provides, in part, that if the sale or exchange of property is certified by the F.C.C. to be necessary or appropriate to effectuate a change in the policy of, or the adoption of a new policy by, the F.C.C. with respect to the ownership and control of radio broadcasting stations, such sale or exchange shall, if the taxpayer so elects, be treated as an involuntary conversion of such property within the meaning of section 1033.

Section 1033(a)(1) of the Code provides that if property is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, no gain shall be recognized.

Sections 1245(b)(4) and 1250(d)(4) of the Code provided that if section 1245 or 1250 property is disposed of

and gain (determined without regard to these sections) is not recognized in whole or part under section 1031, then the amount of gain taken into account by the transferor under sections 1245 or 1250 shall not exceed the amount of gain recognized on such disposition (determined without regard to these sections).

X has entered into an exchange with *Y* whereby *X* exchanged the assets of *K* and *L* in return for *Y*'s transfer of the assets of *H*. *X* and *Y* received property of a like kind to that transferred, assumed no liabilities in connection with the exchange, and will use the assets of *K*, *L*, and *H* in the continuing business of broadcasting after the exchange. *X* will not recognize gain or loss on the exchange pursuant to section 1031(a) of the Code.

Sections 1071 and 1033 of the Code will apply to the transaction to allow *Y*, if it so elects, to treat the exchange of broadcast assets as an involuntary conversion. If *Y* does not elect to use sections 1071 and 1033 or if it was not eligible to receive the tax certificate under section 1071, it would be allowed to defer recognition of gain or loss under section 1031. Since *X* is in compliance with the F.C.C.'s cross-ownership policies, *X* is not eligible to receive a certification under section 1071 similar to that received by *Y*. Section 1031 will apply, however, to allow *X* to defer the recognition of gain or loss.

HOLDING

X's transfer and receipt of property constitutes an exchange of property held for productive use in trade or business solely for property of a like kind to be held for productive use in trade or business, with the result that no gain or loss will be recognized by *X* on the transaction pursuant to section 1031(a).

Y, if it so elects, may treat the exchange of broadcast assets as an involuntary conversion under sections 1071 and 1033 of the Code. If, however, *Y* does not elect to use sections 1071 and 1033 of the Code, *X*'s and *Y*'s transfer and receipt of property constitutes an exchange of property held for productive use in trade or business solely for property of a like kind to be held for productive use in trade or business, with the result that no gain or loss will be recognized by *X* or *Y* on the transaction pursuant to section 1031(a).

Section 1033.—Involuntary Conversions

26 CFR 1.1033(a)-1: Involuntary conversions; nonrecognition of gain.

Whether a corporation that owns and operates a television station and a newspaper may treat an exchange of broadcast assets as an involuntary conversion under sections 1071 and 1033 of the Code. See Rev. Rul. 85-135, page 181.

Section 1034.—Rollover of Gain on Sale of Principal Residence

26 CFR 1.1034-1: Sale or exchange of residence.

Residence; replacement property; stock in cooperative housing corporation exchanged for condominium unit. A tenant-stockholder in a housing corporation, as defined in section 216 of the Code, will not recognize gain or loss upon the exchange of stock in a cooperative housing corporation for a condominium unit, subject to the limitations of section 1034(a) of the Code and section 1.1034-1 of the regulations.

Rev. Rul. 85-132

ISSUE

Will the exchange of stock in a cooperative housing corporation for legal title to a condominium unit and an undivided interest in the common elements, under the facts described below, result in nonrecognition of gain under section 1034 of the Internal Revenue Code?

FACTS

A resides in a building that contains residential units. Prior to January 1985, the building was owned and operated on a cooperative basis by *COOP*, a cooperative housing corporation, as that term is defined in section 216(b)(1) of the Code. *A* was a tenant-stockholder in *COOP* and used the apartment that *A* was entitled to occupy as such stockholder as *A*'s principal residence.

In January 1985, *A* and the other tenant-stockholders of *COOP* converted their equity interests from cooperative ownership to condominium ownership pursuant to the following plan: *COOP* recorded a condominium declaration under which each apartment comprised a separate condominium unit. Initially *COOP* owned legal title to all condominium units and to the common elements. Following recordation of the condominium declaration, *COOP* adopted a plan of complete liquidation. Under the plan, *A* and the other tenant-shareholders surrendered for cancellation all of their shares of *COOP* stock and, in exchange therefor, received only legal title to their respective condominium units and an undivided interest in the elements. *COOP* was then dissolved.

Pursuant to the plan *A* surrendered all of *A*'s shares of stock in *COOP* and received legal title to the condominium unit that *A* occupied and an undivided interest in the common elements. At the time, the value of the condominium unit and *A*'s undivided interest in the common elements exceeded the adjusted basis of *A*'s stock in *COOP*. *A* continues to occupy the unit as *A*'s principal residence.

A did not, within 2 years before the date of the exchange, sell at a gain other property used by *A* as *A*'s principal residence.

LAW AND ANALYSIS

Section 1034(a) of the Code provides that if property (the "old residence") used by the taxpayer as the taxpayer's principal residence is sold by the taxpayer and, within the period beginning 2 years before the date of such sale and ending 2 years after such date, property (the "new residence") is purchased and used by the taxpayer as the taxpayer's principal residence, gain (if any) from such sale shall be recognized only to the extent that the taxpayer's adjusted sales price of the old residence exceeds the taxpayer's cost of purchasing the new residence.

Section 1034(c)(1) of the Code provides that an exchange by the taxpayer of the taxpayer's residence for other property shall be treated as a sale of such residence, and that the acquisition of a residence on the exchange of property shall be treated as a purchase of such residence.

Section 1034(f) of the Code provides, in part, that for purposes of section 1034, references to property used by the taxpayer as the taxpayer's principal residence, and references to the residence of a taxpayer, shall include

stock held by a tenant-stockholder (as defined in section 216) in a cooperative housing corporation (as defined in section 216) if, in the case of stock sold, the house or apartment which the taxpayer was entitled to occupy as such stockholder was used by the taxpayer as the taxpayer's principal residence and, in the case of stock purchased, the taxpayer used as the taxpayer's principal residence the house or apartment which the taxpayer was entitled to occupy as such stockholder.

Rev. Rul. 64-31, 1964-1 (Part 1) C.B. 300, holds that an individual who sells a principal residence and uses the proceeds, within 1 year after the sale, to purchase an apartment in a condominium project which is used as the individual's new principal residence is entitled to the relief provided by section 1034(a) of the Code.

Under section 1034(f) of the Code, the *COOP* stock is considered to be *A*'s principal residence for purposes of section 1034(a). Furthermore, an exchange of the taxpayer's residence for other property constituting a residence is considered to be a sale of a residence and a purchase of another residence under section 1034(c)(1). Accordingly, the exchange of *COOP* stock for the condominium unit and an undivided interest in the common elements is considered to be a sale of the taxpayer's residence, and the receipt of the condominium unit and an undivided interest in the common elements for the stock is considered to be a purchase of a residence for purposes of section 1034.

HOLDING

Based on the facts and circumstances presented, the exchange of *A*'s shares of stock in *COOP* for legal title to the condominium unit occupied by *A* and an undivided interest in the common elements will qualify as a sale within the meaning of section 1034(a) of the Code, and no gain or loss will be recognized to *A* on such sale, subject to the limitations of section 1034(a) of the Code and section 1.1034-1 of the Income Tax Regulations.

Part V.—Changes to Effectuate F.C.C. Policy

Section 1071.—Gain from Sale or Exchange to Effectuate Policies of F.C.C.

26 CFR 1.1071-1: Gain from sale or exchange to effectuate policies of Federal Communication Commission.

Whether a corporation that owns and operates a television station and a newspaper may treat an exchange of broadcast assets as an involuntary conversion under sections 1071 and 1033 of the Code. See Rev. Rul. 85-135, page 181.

Part VII.—Wash Sales; Straddles

Section 1092.—Straddles

26 CFR 1.1092(b)-4T: Mixed straddles; mixed straddle account (temporary).
(Also Section 6081; 1.6081-1T.)

T.D. 8058

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Mixed Straddle Account Elections Under Section 1092(b)(2)

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document amends temporary regulations relating to the election to establish mixed straddle accounts. Changes in the applicable tax law were made by the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. These regulations provide Internal Revenue Service personnel who administer the Internal Revenue Code and members of the public with the guidance necessary to make the election and comply with the law.

DATE: The regulations apply to positions held on or after January 1, 1984, and are effective upon publication in the Federal Register.

FOR FURTHER INFORMATION CONTACT: Timothy J. McKenna of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T). Telephone 202-566-4336 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains amendments to the Temporary Income Tax Regulations (26 CFR Part 1) under section 1092(b) of the Internal Revenue Code of 1954 which were published in the FEDERAL REGISTER on January 24, 1985 (50 FR 3324) [T.D. 8008, 1985-1 C.B. 276]. A notice of proposed rulemaking cross-referencing these temporary regulations also was published in the same issue of the FEDERAL REGISTER (50 FR 3351) [LR-299-84, 1985-1 C.B. 663]. These amendments conform the regulations to section 103 of the Tax Reform Act of 1984 (Pub. L. 98-369, 98 Stat. 62) [1984-3 C.B. (Vol. 1) 1, 135]. The temporary regulations provided by this document will remain in effect until suspended by final regulations on this subject.

SUMMARY OF CHANGES IN TEMPORARY REGULATION

This document amends §1.1092(b)-4T(f), relating to the time for making a mixed straddle account election. Under the prior rules, a mixed straddle account election was effective for the year for which it was made and for all subsequent taxable years. The regulation also provided that the election could be revoked only with the consent of the Commissioner. The election was to be made by the due date (taking extensions into account) of the taxpayer's income tax return for the taxable year for which the mixed straddle account was established. The revised temporary regulations provide in §1.1092(b)-4T(f)(4) that an election will be effective only for the taxable year for which it is made. Section 1.1092(b)-4T(f)(1) of the revised temporary regulations provides that the election to establish one or more mixed straddle accounts for a taxable year must be made by the due date (without regard to extensions) of the taxpayer's income tax return for the immediately preceding taxable year. Section 1.1092(b)-4T(f)(2) of the revised temporary regulations prescribes that the election is to be made on Form 6781 and by attaching the Form and a statement designating with specificity the class of activities for which a mixed straddle account is established to the taxpayer's income tax return for the immediately preceding taxable year (or request for an automatic extension). Section 1.1092(b)-4T(f)(3) of the revised temporary regulations sets forth transitional rules for calendar and fiscal year

taxpayers. Under the revised regulations, calendar year taxpayers must make mixed straddle account elections for taxable years 1984 and 1985 by December 31, 1985. With respect to fiscal year taxpayers, the revised regulations provide that the deadline for making mixed straddle account elections for fiscal years ending before September 1, 1986 (or, in the case of a corporation, October 1, 1986), will not be earlier than December 31, 1985. The December 31, 1985 date for making the election represents an extension of time to make the election from the October 15, 1985 date set forth in IR-85-78, issued on August 8, 1985, and Announcement 85-112, published in I.R.B. 1985-33, dated August 19, 1985.

The news release also informed certain individuals, trusts, estates, and partnerships holding mixed straddles that they would be allowed an extension of time until October 15, 1985, to file their income tax returns. New temporary regulation §1.6081-1T is being added to reflect this extension. However, no extension of the October 15, 1985 date for filing these returns is provided in these regulations.

SPECIAL ANALYSIS

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for temporary regulations. Accordingly, the Regulatory Flexibility Act (5 U.S.C. Chapter 6) does not apply, and no regulatory flexibility analysis is required for this rule.

The Commissioner of Internal Revenue has determined that this rule is not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis is therefore not required.

DRAFTING INFORMATION

The principal author of these temporary regulations is Timothy J. McKenna of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * Section 1.1092(b)-4T also issued under 26 U.S.C. 1092(b)(2).

Par. 2. Paragraph (f) of §1.1092(b)-4T is revised to read as follows:

§1.1092(b)-4T Mixed straddles; mixed straddle account (temporary).

* * * * *

(f) *Election*—(1) *Time for making the election.* Except as otherwise provided, the election under this section to establish one or more mixed straddle accounts for a taxable year must be made by the due date (without regard to automatic and discretionary extensions) of the taxpayer's income tax return for the immediately preceding taxable year (or part thereof). For example, an individual taxpayer on a calendar year basis must make the election by April 15, 1986, to establish one or more mixed straddle accounts for taxable year 1986. Similarly, a calendar year corporate taxpayer must make its election by March 15, 1986, to establish one or more mixed straddle accounts for 1986. If a taxpayer begins trading or investing in positions in a new class of activities during a taxable year, the election under this section with respect to the new class of activities must be made by the taxpayer by the later of the due date of the taxpayer's income tax return for the immediately preceding taxable year (without regard to automatic and discretionary extensions), or 60 days after the first mixed straddle in the new class of activities is entered into. Similarly, if on or after the date the election is made with respect to an account, the taxpayer begins trading or investing in positions that are includible in such account but were not specified in the original election, the taxpayer must make an amended election as prescribed in paragraph (f)(2)(ii) of this section by the later of the due date of the taxpayer's income tax return for the immediately preceding taxable year (without regard to automatic and discretionary extensions), or 60 days after the acquisition of the first of the positions. If an election is made after the times specified in this paragraph (f)(1), the election will be permitted only if the Commissioner concludes that the taxpayer had reasonable cause for failing to make a timely election. For example, if a calendar year taxpayer holds few positions in one class of activities prior to April 15 of a taxable year, and the taxpayer greatly increases trading activity with respect to positions in the class of activities after April 15, then the Commissioner may conclude that the taxpayer had reasonable cause for failing to make a timely election and allow the taxpayer to make a mixed straddle account election for the taxable year. See paragraph (f)(2) of this section for rules relating to the manner for making these elections.

(2) *Manner for making the election*—(i) *In general.* A taxpayer must make the election on Form 6781 in the manner prescribed by such Form, and by attaching the Form to the taxpayer's income tax return for the immediately preceding taxable year (or request for an automatic extension). In addition, the taxpayer must attach a statement to Form 6781 designating with specificity the class of activities for which a mixed straddle account is established. The designation must describe the class of activities in sufficient detail so that the Commissioner may determine, on the basis of the designation, whether specific positions are includible in the mixed straddle account. In the case of a taxpayer who elects to establish more than one mixed straddle account, the Commissioner must be able to determine, on the basis of the designations, that specific positions are placed in the appropriate account. The election applies to all positions in the designated class of activities held by the taxpayer during the taxable year.

(ii) *Elections for new classes of activities and expanded elections.* Amended elections and elections made with respect to a new class of activities that the taxpayer has begun trading or investing in during a taxable year, shall be made on Form 6781 within the times prescribed in paragraph (f)(1) of this section. A statement must be attached to the Form containing the information required in paragraph (f)(2)(i) of this section, with respect to the new or expanded designated class of

activities.

(iii) *Special rule.* The Commissioner may disregard a mixed straddle account election if the Commissioner determines, on the basis of all the facts and circumstances, that the principal purpose for making the mixed straddle account election with respect to a class of activities was to avoid the rules of §1.1092(b)-1T(a). For example, if a taxpayer holds stock that is not part of a straddle and that would generate a loss if sold or otherwise disposed of, and the taxpayer both acquires offsetting option positions with respect to the stock and makes a mixed straddle account election with respect to the stock and stock options near the end of a taxable year, the Commissioner may disregard the mixed straddle account election.

(3) *Special rule for taxable years ending after 1983 and before September 1, 1986.* An election under this section to establish one or more mixed straddle accounts for any taxable year that includes July 17, 1984, and any taxable year that ends before September 1, 1986 (or, in the case of a corporation, October 1, 1986), must be made by the later of—

(i) December 31, 1985, or

(ii) The due date (without regard to automatic and discretionary extensions) of the return for the taxpayer's taxable year that begins in 1984 if the due date of the taxpayer's return for such year (without regard to automatic and discretionary extensions) is after December 31, 1985.

The election shall be made by attaching Form 6781 together with a statement to the taxpayer's income tax return, amended return, or other appropriate form that is filed on or before the deadline determined in the preceding sentence. The attached statement must designate with specificity, in accordance with paragraph (f)(2)(i) of this section, the class of activities for which a mixed straddle account is established. For example, if a fiscal year taxpayer's return (for its taxable year ending September 30, 1985) is due (without regard to extensions) on January 15, 1986, and the taxpayer intends to obtain an automatic extension to file the return, the election under this section for any or all of the fiscal years ending in 1984, 1985 or 1986 must be made on or before January 15, 1986, with the request for an automatic extension. Similarly, a calendar year taxpayer (whether or not such taxpayer has obtained an automatic extension of time to file) who has filed its 1984 income tax return before October 15, 1985, without making a mixed straddle account election for either 1984 or 1985, or both, may make the mixed straddle account election under this section for either or for both of such years with an amended return filed on or before December 31, 1985. The mixed straddle account elected on this amended return will be effective for all positions in the designated class of activities even if the taxpayer had elected straddle-by-straddle identification as provided under §1.1092(b)-3T for purposes of the previously filed 1984 income tax return. For taxable years beginning in 1984 and 1985, the election under this paragraph (f)(3) is effective for the entire taxable year. For taxable years beginning in 1983, an election shall be effective for that part of the year beginning after December 31, 1983, for which the election under §§1.1256(h)-1T or 1.1256(h)-2T is made. See §1.6081-1T regarding an extension of time to file certain individual income tax returns.

(4) *Period for which election is effective.* For taxable years beginning on or after January 1, 1984, an election under this section, including an amendment to the election pursuant to paragraph (f)(1) of this section, shall be effective only for the taxable year for which the election is made. This election may be revoked during the taxable year for the remainder of the taxable year only with the consent of the Commissioner. An application for consent to revoke the election shall be filed with the service center with which the election was filed and shall—

(i) Contain the name, address, and taxpayer identification number of the taxpayer;

(ii) Show that the volume or nature of the taxpayer's activities has changed substantially since the election was made, and that the taxpayer's activities no longer warrant the use of such mixed straddle account; and

(iii) Any other relevant information.

If a taxpayer's election for a taxable year is revoked, the taxpayer may not make a new election for the same class of activities under paragraph (f)(1) of this section during the same taxable year.

Par. 3. A new §1.6081-1T is added immediately after §1.6081-1 to read as set forth below.

§1.6081-1T Extension of time to file return in case of taxpayers with mixed straddles (temporary).

The due date for the income tax return of trusts, estates, partnerships, and individual taxpayers filing their return for calendar year 1984 or for a fiscal year ending before February 1, 1985, shall be October 15, 1985, if—

(a) The taxpayer obtained an extension of time to file the return pursuant to §1.6081-1 or §1.6081-4, and the due date for the return (taking the extension into account) falls after August 7, 1985 and before October 16, 1985;

(b) The taxpayer did not file the return prior to August 8, 1985; and

(c) The taxpayer held one or more mixed straddles (within the meaning of section 1092(b)(2)) at any time after December 31, 1983, and before August 8, 1985.

There is need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impractable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved October 10, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on October 11, 1985, 10:07 a.m., and published in the issue of the Federal Register for October 17, 1985, 50 F.R. 42012)

Subchapter P.—Capital Gains and Losses
Part III.—General Rules for Determining Capital Gains and Losses

Section 1223.—Holding Period of Property

26 CFR 1.1223-1 Determination of period for which capital assets are held.

Holding periods of stock and securities received in section 351 exchange when transferred property had varying holding periods. See Rev. Rul. 85-164, page 117.

Part V.—Special Rules for Bonds and Other Debt Instruments
Subpart A.—Original Issue Discount

Section 1274—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 467, 483, 7872; 1.483-1)

Federal short-term mid-term, and long-term rates. For purposes of section 1274(d) of the Code, relating to certain transactions in which a debt instrument is issued for property, a table sets forth the applicable federal short-term, mid-term, and long-term rates for December 1985.

Rev. Rul. 85-190

Section 1274(d) of the Internal Revenue Code, as amended by section 101(b)(1) of the 1985 imputed interest simplification act (the Act), Pub. L. No. 99-121, page 367, this Bulletin, provides that the applicable federal short-term, mid-term, and long-term rates shall be determined each month. Section 1274(d), as amended, is effective for sales and exchange transactions made after June 30, 1985.

The applicable federal rates are relevant under several Code provisions, including sections 1274 and 483. These sections relate to certain transactions in which a debt instrument is issued in exchange for property and, when applicable, they generally provide the minimum interest rate that must be stated in the debt instrument in order to avoid having interest imputed for federal income tax purposes at a higher rate than the stated rate.

Prior to the amendment of section 1274(d) of the Code by section 101(b)(1) of the Act, the applicable federal rates were determined semiannually, and monthly rates were computed under the alternate method provided by section 1.274-6T of the Temporary Income Tax Regulations. The method now prescribed by section 1274(d), as amended, reflects this prior alternate method. Accordingly, the published alternate rates for July 1985 and subsequent months may be used as the applicable federal rates under section 1274(d).

Under sections 1274 and 483 of the Code, the test and imputed interest rates generally are each equal to the applicable federal rate. Under section 1274(e), however, the rate for a sale-leaseback transaction is 110 percent of the applicable federal rate. Moreover, 110 percent of the applicable federal rate continues to be relevant under section 467 (relating to certain payments for the use of property or services) and 120 percent of the applicable federal rate continues to be relevant under section 280G (relating to golden parachute payments).

Pursuant to section 1274(d) of the code, the short-term, mid-term, and long-term applicable federal rates (AFR) for the month of December 1985 are as follows:

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	8.59%	8.41%	8.32%	8.27%
110% AFR	9.46%	9.25%	9.15%	9.08%
120% AFR	10.34%	10.09%	9.97%	9.88%
Mid-Term				
AFR	9.91%	9.68%	9.57%	9.49%
110% AFR	10.93%	10.65%	10.51%	10.42%
120% AFR	11.96%	11.62%	11.46%	11.35%
Long-Term				
AFR	10.60%	10.33%	10.20%	10.11%
110% AFR	11.68%	11.36%	11.20%	11.10%
120% AFR	12.78%	12.40%	12.21%	12.09%

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26 CFR 1.1274-3T: Adequate stated interest for certain debt instruments issued after February 28, 1985.
(Also Sections 280G, 467, 468, 483, 7872; 1.483-1.)

Rev. Rul. 85-170

For purposes of section 1274(d) of the Internal Revenue Code, the short-term, mid-term, and long-term applicable federal rates (AFR) for the six-month period, January 1, 1986 through June 30, 1986, are as follows:

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	8.92%	8.73%	8.64%	8.58%
110% AFR	9.83%	9.60%	9.49%	9.41%
120% AFR	10.75%	10.48%	10.35%	10.26%
Mid-Term				
AFR	10.47%	10.21%	10.08%	10.00%
110% AFR	11.55%	11.23%	11.08%	10.98%
120% AFR	12.63%	12.25%	12.07%	11.95%
Long-term				
AFR	11.11%	10.82%	10.68%	10.58%
110% AFR	12.25%	11.90%	11.73%	11.62%
120% AFR	13.40%	12.98%	12.78%	12.64%

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26 CFR 1.1274-6T: Alternate method for determining applicable federal rate
(Also Sections 467, 483, 7872; 1.483-1.)

Federal short-term, mid-term, and long-term rates. For purposes of section 1274(d) of the Code, relating to certain transactions in which a debt instrument is issued for property, tables set forth the applicable federal short-term, mid-term, and long-term rates for July 1985 under an alternate method provided by section 1.1274-6T of the Temporary Income Tax Regulations.

Rev. Rul. 85-91

Pursuant to section 1.1274-6T of the Temporary Income Tax Regulations, the short-term, mid-term, and long-term applicable federal rates (AFR) for the month of July 1985 computed under the alternate method are as follows:

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short Term				
AFR	8.69%	8.51%	8.42%	8.36%
110% AFR	9.58%	9.36%	9.25%	9.18%
120% AFR	10.47%	10.21%	10.08%	10.00%
Mid-Term				
AFR	10.23%	9.98%	9.86%	9.78%
110% AFR	11.28%	10.98%	10.83%	10.74%
120% AFR	12.34%	11.98%	11.81%	11.69%
Long-Term				
AFR	10.90%	10.62%	10.48%	10.39%
110% AFR	12.02%	11.68%	11.51%	11.41%
120% AFR	13.15%	12.74%	12.54%	12.41%

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26 CFR 1.1274-6T: Alternate method for determining applicable federal rate.
(Also Sections 467, 483, 7872; 1.483-1.)

Rev. Rul. 85-117[1]

Pursuant to section 1.1274-6T of the Temporary Income Tax Regulations, the short-term, mid-term, and long-term applicable federal rates (AFR) for the month of August 1985 computed under the alternate method are as follows:

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	8.41%	8.24%	8.16%	8.10%
110% AFR	9.27%	9.06%	8.96%	8.89%
120% AFR	10.13%	9.89%	9.77%	9.69%
Mid-Term				
AFR	10.02%	9.78%	9.66%	9.59%
110% AFR	11.05%	10.76%	10.62%	10.53%
120% AFR	12.08%	11.74%	11.57%	11.46%
Long-Term				
AFR	10.72%	10.45%	10.32%	10.23%
110% AFR	11.83%	11.50%	11.34%	11.23%
120% AFR	12.93%	12.54%	12.35%	12.22%

[1]Also released as News Release IR-85-69, dated July 19, 1985.

26 CFR 1.1274-6T: Alternate method for determining applicable federal rate.
(Also Sections 467, 483, 7872; 1.483-1.)

Federal short-term, mid-term, and long-term rates. For purposes of section 1274(d) of the Code, relating to certain transactions in which a debt instrument is issued for property, a table sets forth the applicable fed-

eral short-term, mid-term, and long-term rates for September 1985 under an alternate method provided by section 1.1274-6T of the Temporary Income Tax Regulations.

Rev. Rul. 85-137

Pursuant to section 1.1274-6T of the Temporary Income Tax Regulations, the short-term, mid-term, and long-term applicable federal rates (AFR) for the month of September 1985 computed under the alternate method are as follows:

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	8.74%	8.56%	8.47%	8.41%
110% AFR	9.64%	9.42%	9.31%	9.24%
120% AFR	10.53%	10.27%	10.14%	10.06%
Mid-Term				
AFR	10.31%	10.06%	9.94%	9.86%
110% AFR	11.38%	11.07%	10.92%	10.82%
120% AFR	12.43%	12.07%	11.89%	11.78%
Long-Term				
AFR	10.98%	10.69%	10.55%	10.46%
110% AFR	12.11%	11.76%	11.59%	11.48%
120% AFR	13.24%	12.83%	12.63%	12.50%

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26 CFR 1.1274-6T: Alternate method for determining applicable federal rate.
(Also Sections 467, 483, 7872.)

Rev. Rul. 85-154

Pursuant to section 1.274-6T of the Temporary Income Tax Regulations, the short-term, mid-term, and long-term applicable federal rates (AFR) for the month of October 1985 computed under the alternate method are as follows:

	Period for Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-Term				
AFR	8.71%	8.53%	8.44%	8.38%
110% AFR	9.60%	9.38%	9.27%	9.20%
120% AFR	10.50%	10.24%	10.11%	10.03%
Mid-Term				
AFR	10.17%	9.92%	9.80%	9.72%
110% AFR	11.21%	10.91%	10.77%	10.67%
120% AFR	12.25%	11.90%	11.73%	11.62%
Long-Term				
AFR	10.83%	10.55%	10.41%	10.33%
110% AFR	11.95%	11.61%	11.45%	11.34%
120% AFR	13.06%	12.66%	12.47%	12.34%

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26 CFR 1.1274-6T: Alternate method for determining applicable federal rate.
(Also Sections 467, 483, 7872.)

Rev. Rul. 85-181

Pursuant to section 1.1274-6T of the Temporary Income Tax Regulations, the short-term, mid-term, and long-term applicable federal rates (AFR) for the month of November 1985 computed under the alternate method are as follows:

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	8.68%	8.50%	8.41%	8.35%
110% AFR	9.57%	9.35%	9.24%	9.17%
120% AFR	10.46%	10.20%	10.07%	9.99%
Mid-Term				
AFR	10.21%	9.96%	9.84%	9.76%
110% AFR	11.26%	10.96%	10.81%	10.72%
120% AFR	12.31%	11.95%	11.78%	11.66%
Long-term				
AFR	10.91%	10.63%	10.49%	10.40%
110% AFR	12.03%	11.69%	11.52%	11.42%
120% AFR	13.17%	12.76%	12.56%	12.43%

Section 1275.—Other Definitions and Special Rules

26 CFR 1.1275-3T: Original issue discount information reporting requirements (Temporary).

T.D. 8030

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Original Issue Discount Reporting Requirements

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary regulations relating to reporting requirements for original issue discount on publicly offered debt instruments as prescribed by section 1275(c)(2) of the Internal Revenue Code of 1954, which was added by section 41 of the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1, 39]. The temporary regulations are necessary to provide issuers of debt instruments having original issue discount with the immediate guidance needed to meet the requirements of section 1275(c)(2). The regulations are also necessary to provide guidance to officers and employees of the Internal Revenue Service with respect to the requirements of that section.

DATES: The regulations under section 1275(c)(2) apply to publicly offered debt instruments having original issue discount that are issued after August 16, 1984 and are effective June 18, 1985.

FOR FURTHER INFORMATION CONTACT: Theresa E. Bearman of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (LR-125-84). Telephone (202-566-3459) (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document provides temporary regulations relating to reporting requirements for original issue discount on publicly offered debt instruments as prescribed by section 1275(c)(2) of the Internal Revenue Code of 1954, which was added by section 41 of the Tax Reform Act of 1984 (98 Stat. 494).

The Tax Reform Act of 1984 recodified and expanded the rules relating to the tax treatment of original issue discount as previously set forth in sections 1232, 1232A, and 1232B of the Internal Revenue Code of 1954. Section 1275(c)(2) of the Code requires the issuer of a publicly offered debt instrument having original issue discount to furnish the Secretary certain information with respect to such an issue.

NEW RULES

These temporary regulations require an issuer of a publicly offered debt instrument issued at a discount to furnish the Secretary with his name, address, and taxpayer identification number, the issue date, maturity date, and CUSIP number of the issue, the amount of original issue discount for the entire issue, the issue price, the stated redemption price at maturity, the stated interest rate and dates of interest payments, a description of the issue, the method selected for determining the amount of original issue discount allocable to a short accrual period, and such other information as may be required.

QUESTIONS RESERVED

The temporary regulations do not address the question of the proper method of determining the amount of original issue discount of a debt instrument which is part of a serial issue nor do they address, for purposes of section 1275(c)(2), the proper method for determining the issue price of a stripped bond or coupon. Additionally, the regulations do not address information reporting requirements under section 1275(c)(1). These questions are under active consideration by the Internal Revenue Service.

REGULATORY FLEXIBILITY ACT

A general notice of proposed rulemaking is not required by 5 U.S.C. 553 for temporary regulations. Accordingly, the temporary regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chpater 6).

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Commissioner of Internal Revenue has determined that this temporary rule is not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis therefore is not required.

PAPERWORK REDUCTION ACT

The collection of information contained in these regulations has been submitted to the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these temporary regulations is Theresa E. Bearman of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations.

Accordingly, 26 CFR Part 1 and Part 602 are amended as follows:

PART 1
INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Paragraph 1. The authority citation for Part 1 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 2. A new §1.1275-3T is added immediately following §1.1274-6T. New §1.1275-3T reads as follows:

§1.1275-3T Original issue discount information reporting requirements (Temporary)

(a) [Reserved]

(b) *Information required to be reported to Secretary*—(1) *In general.* In the case of any issue of publicly offered debt instruments issued after August 16, 1984, that have original issue discount other than an issue of debt instruments described in section 1272(a)(2), the issuer must make an information return on Form 8281. The term "issuer" includes not only domestic issuers but also any foreign issuer who is otherwise subject to United States income tax law, unless the issue is neither listed on an established securities market (as defined in §1.453-3(d)(4)) in the United States nor offered for sale or resale in the United States in connection with its original issuance. In addition, any person who makes a public offering of stripped bonds or stripped coupons (as defined in section 1286(e)(2) and (e)(3), respectively) is treated as an issuer of publicly offered debt instruments having original issue discount.

(2) *Information required to be reported.* The following information shall be reported to the Secretary on Form 8281—

(i) The name, address, and taxpayer identification number of the issuer;

(ii) The issue date (as defined in section 1275(a)(2)), maturity date, and CUSIP number of the issue;

(iii) The amount of original issue discount for the entire issue (as defined in section 1273(a)(1));

(iv) The issue price (ad defined in section 1273(b)) expressed as a percentage of the principal amount;

(v) The stated redemption price at maturity of the entire issue, or of each debt instrument within the issue if in denominations of other than $1,000;

(vi) The stated interest rate and the interest payment dates;

(vii) A description of the debt instrument, or, in place of the description, a copy of the offering circular or prospectus, which description shall include a statement of any terms and conditions of the instrument that govern—

(A) Whether payments of principal may be made prior to maturity of the debt instrument;

(B) Whether the debt instrument is part of an investment unit;

(C) Whether the debt instrument is issued in an exchange described in section 368(a);

(D) Whether the debt instrument is part of a serial issue;

(E) Whether the debt instrument is a stripped bond or stripped coupon; and

(F) Whether the debt instrument is collateralized by United States Treasury bonds;

(viii) The method selected for computing the amount of original issue discount allocable to a short accrual period; and

(ix) Such other information as is required by the form.

(3) *Time and manner of filing of information return*—(i) The information return required by paragraph (b)(1) of this section shall be filed on Form 8281 with the Internal Revenue Service at the address specified on the form. This return must be made on Form 8281 regardless of whether other information returns are filed by use of electronic media.

(ii) Form 8281 shall be filed with respect to each issue of publicly offered debt instruments—

(A) For debt instruments issued after May 31, 1985, within 30 days after date of issuance; and

(B) For debt instruments issued after August 16, 1984, and before June 1, 1985, on or before July 1, 1985.

(4) *Penalty.* For rules relating to the penalty provided for failure to make an information return under paragraph (b) of this section, see section 6706(b) and the regulations under that section.

PART 602
OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. Section 602.101(c) is amended by inserting in the appropriate places in the table "§1.1275-3T....1515-".

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved May 24, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 17, 1985, 8:45 a.m., and published in the

issue of the Federal Register for June 18, 1985, 50 F.R. 25219)

Subchapter S.—Tax Treatment of S Corporations and Their Shareholders
Part I.—In General

Section 1361.—S Corporation Defined

Small business S corporation; stock purchase agreement; second class of stock. A stock purchase agreement executed between a corporation and its shareholders, that does not affect the shareholders' rights in the corporation's profits and assets, will not create a second class of stock for purposes of section 1361(b)(1)(D) of the Code.

Rev. Rul. 85-161

ISSUE

Will the stock purchase agreement described below cause a corporation to be treated as having more than one class of stock within the meaning of Section 1361(b)(1)(D) of the Internal Revenue Code?

FACTS

Corporation *X* has two classes of stock issued and outstanding: voting common stock and nonvoting common stock. The nonvoting stock is held by *A*, *B*, and *C*, siblings, and by *D*, an unrelated individual who is an officer of the corporation. *A* and *B* own all the voting stock. The voting and nonvoting shares are identical other than with respect to voting rights and other than as provided in a shareholder's agreement described below.

X and all the shareholders of *X* have entered into an agreement with respect to the transfer of *D*'s stock. Under the agreement, *D* may transfer *D*'s stock only after obtaining the consent of the holders of voting stock in *X*. If such consent cannot be obtained, *D* may sell the stock only to the corporation or the other shareholders at book value. Other provisions of the agreement give *X* or the other shareholders the right to purchase *D*'s stock in the event of *D*'s termination of employment or disability and upon *D*'s death.

X filed an election to be an S corporation under section 1362 of the Code with respect to its taxable year beginning Januarry 1, 1984.

LAW AND ANALYSIS

Section 1361(b)(1)(D) of the Code provides that the term "small business corporation" means a corporation that does not have more than one class of stock.

Section 1361(c)(4) of the Code provides that for purposes of section 1361(b)(1)(D), a corporation will not be treated as having more than one class of stock solely because there are differences in voting rights among the shares of common stock.

Although there may be differences in voting rights among the shares of common stock, the outstanding shares of a corporation must be identical as to the rights of the holders in the profits and in the assets of the corporation. S. Rep. No. 97-640, 97th Cong., 2d Sess. 8 (1982), 1982-2 C.B. 718, 721.

In this case, all shares of *X*'s stock are equal with respect to rights to profits and rights in the assets of the corporation. The agreement restricting the transfer of *D*'s stock does not affect *D*'s interest in corporate profits or corporate assets while *D* is a shareholder. Therefore, *X* does not have more than one class of stock within the meaning of section 1361(b)(1)(D) of the Code.

HOLDING

The stock purchase agreement with respect to stock held by *D* will not cause the corporation to be treated as having more than one class of stock for purposes of section 1361(b)(1)(D) of the Code.

Chapter 3.—Withholding of Tax on Nonresident Aliens and Foreign Corporations
Subchapter A.—Nonresident Aliens and Foreign Corporations

Section 1441.—Withholding of Tax on Nonresident Aliens

26 CFR 1.1441-1: Requirement for withholding of tax on nonresident aliens, foreign partnerships, and foreign corporations.

Requirements and conditions under which Forms 1042S withholding information returns may be filed on magnetic tape. See Rev. Proc. 85-53, page 721.

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26 CFR 1.1441-2: Income subject to withholding. (Also Section 1442; 1.1442-1.)

Withholding of tax on nonresidents; interest. Withholding of tax pursuant to sections 1441 and 1442 of the Code on interest paid to nonresident aliens and foreign corporations on obligations that are purchased between interest payment dates is based on the gross amount of interest paid on the interest payment date.

Rev. Rul. 85-193

ISSUE

Whether withholding of tax pursuant to sections 1441 and 1442 of the Internal Revenue Code on United States source interest paid to nonresident aliens and foreign corporations on obligations that are purchased between interest payment dates is based on the gross amount of interest paid on the interest payment date or on the amount of interest that has accrued from the date of purchase.

FACTS

X, a domestic bank, acts as a custodian for obligations which are in registered form and are owned by nonresident aliens and foreign corporations. *X*, as custodian, holds the obligations on account for its nonresident alien and foreign corporate customers and forwards United States source interest paid on the obligations to its customers. Some of the obligations held by *X* for its customers were purchased between interest payment dates at a price that reflected the principal value of the obligation plus interest accrued to the date of purchase.

The interest on the obligations held by *X* is not portfolio interest within the meaning of section 871(h) and 881(c) of the Code and is not effectively connected with the conduct of a trade or business within the United States.

LAW AND ANALYSIS

Section 1441(a) of the Code provides in general that all persons, in whatever capacity acting (including fiduciaries) having the control, receipt, custody, disposal, or payment of any of the items of income specified in section 1441(b) (to the extent that any of such items constitutes gross income from sources within the United States), of any nonresident alien individual or of any foreign partnership shall deduct and withhold from such items a tax equal to 30 percent thereof. The items

of income specified in section 1441(b) include interest (other than original issue discount as defined in section 1273) and other fixed or determinable annual or periodical gains, profits, and income. Section 1442(a) provides for withholding of tax in the same manner with respect to the same items of income in the case of foreign corporations.

Section 1.1441-2(a)(1) of the Income Tax Regulations provides that the gross amount of fixed or determinable annual or periodical income is subject to withholding and specifically includes interest in such items of income.

Section 1.1441-3(c)(3) of the regulations concerning exceptions and rules of special application provides that tax shall be withheld at the source on the gross amount of interest without regard to whether or not the payment constitutes a return of capital or the payment of income within the meaning of section 61. The section, by example, states that tax shall be withheld on the gross amount on interest payments upon bonds which were purchased flat at quotations representing the price of both the bonds and the defaulted matured interest coupons.

HOLDING

Withholding of tax pursuant to section 1441 and 1442 of the Code on United States source interest paid to nonresident aliens and foreign corporations on obligations that are purchased between interest payment dates is based on the gross amount of interest paid.

Accordingly, *X* must withhold tax pursuant to sections 1441 and 1442 of the Code on United States source interest paid by it on obligations that are purchased by its customers between interest payment dates, based on the gross amount of interest paid following the date of purchase.

Section 1442.—Withholding of Tax on Foreign Corporations

26 CFR 1.1442-1: Withholding of tax on foreign corporations.

Requirements and conditions under which Forms 1042S withholding information returns may be filed on magnetic tape. See Rev. Proc. 85-53, page 721.

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26 CFR 1.1442-1: Withholding of tax on foreign corporations.

Whether withholding of tax pursuant to sections 1441 and 1442 of the Code on United States source interest paid to nonresident aliens and foreign corporations on obligations that are purchased between interest payment dates is based on the gross amount of interest paid on the interest payment date or on the amount of interest that has accrued from the date of purchase. See Rev. Rul. 85-193, page 191.

Section 1443.—Foreign Tax-Exempt Organizations

26 CFR 1.1443-1: Foreign tax-exempt organizations.

Requirements and conditions under which Forms 1042S withholding information returns may be filed on magnetic tape. See Rev. Proc. 85-53, page 721.

Section 1445.—Withholding of Tax on Dispositions of United States Real Property Interests

Procedures to be followed to obtain a withholding certificate for purposes of withholding on dispositions by foreign persons of U.S. real property interests. See Rev. Proc. 85-41, page 482.

Subchapter B—Application of Withholding Provisions

Section 1461.—Liability for Withheld Tax

26 CFR 1.1461-2: Return of tax withheld.

Requirements and conditions under which Forms 1042S withholding information returns may be filed on magnetic tape. See Rev. Proc. 85-53, page 721.

Section 1462.—Withheld Tax as Credit to Recipient of Income

26 CFR 1.1462-1: Withheld tax as credit to recipient of income.

Requirements and conditions under which Forms 1042S withholding information returns may be filed on magnetic tape. See Rev. Proc. 85-53, page 721.

Section 1463.—Tax Paid by Recipient of Income

26 CFR 1.1463-1: Tax paid by recipient on income.

Requirements and conditions under which Forms 1042S withholding information returns may be filed on magnetic tape. See Rev. Proc. 85-53, page 721.

Section 1464.—Refunds and Credits with Respect to Withheld Tax

26 CFR 1.1464-1: Refunds or credits.

Requirements and conditions under which Forms 1042S withholding information returns may be filed on magnetic tape. See Rev. Proc. 85-53, page 721.

Chapter 6.—Consolidated Returns
Subchapter A.—Returns and Payment of Tax

Section 1502.—Regulations

26 CFR 1.1502-13: Intercompany transactions. (Also Sections 453A, 1001; 1.453-1.)

Consolidated returns; intercompany transactions. A parent corporation that is a dealer in personal property may not treat the extension of credit by its subsidiary, a national bank, to the parent corporation's customers as equivalent to the parent corporation selling on the installment basis to its customers and then selling the installment obligations in a deferred intercompany transaction to its subsidiary.

Rev. Rul. 85-133

Under the circumstances described below, may *P* treat the extension of credit by *BK* to *P*'s customers and the sale of merchandise by *P* to these same credit customers as equivalent to *P* selling on the installment basis to its customers and then selling the installment obligations in a deferred intercompany transaction to *BK*?

FACTS

P is the common parent of an affiliated group of corporations that files consolidated federal income tax returns. *P* is a retailer providing merchandise and services to customers and is using the accrual method of accounting for federal income tax purposes.

P and *BK*, a national bank, is a member of *P*'s affiliated group.

P and *BK* have entered into an agreement in which *BK* extends credit to *P*'s customers by issuing credit cards that can only be used by *P*'s customers to purchase merchandise and services from *P*. The face amount of each purchase is paid by *BK* to *P*, reduced by a fee equivalent to a merchant discount. *BK* is entitled to any finance charge income. Under the terms of the credit agreement, the cardholder may make two or more payments for credit purchases of *P*'s merchandise.

For federal income tax reporting purposes *P* has returned the income from its credit sales on the installment

method as if it had originated the installment obligations and had "sold" the installment obligations to *BK* in a deferred intercompany transaction.

LAW AND ANALYSIS

Section 1.1502-13(a)(1)(i) of the regulations defines an "intercompany transaction" to be a transaction during a consolidated return year between corporations that are members of the same group immediately after such transaction. A "deferred intercompanay transaction" is defined by section 1.1502-13(a)(2) as the sale or exchange of property.

Section 1.1502-13(c) of the regulations provides that to the extent gain or loss is recognized under the Code for a consolidated return year, such gain or loss shall be deferred by the selling member according to specific rules set forth in section 1.1502-13(d), (e) and (f) governing restoration of such deferred gain or loss.

Section 1.1502-13(e)(1) of the regulations provides for the restoration of gain or loss on satisfaction of an installment obligation transferred in a deferred intercompany transaction.

Section 1.1502-17(a) of the regulations provides that the method of accounting to be used by *each* member of the group shall be determined in accordance with the provisions of section 446 *as if such member filed a separate return*. (Emphasis added).

Section 446(c) of the Internal Revenue Code provides that a taxpayer may compute its taxable income under any permissible method of accounting, provided that it is the basis upon which the taxpayer regularly computes its income in keeping its books and the method clearly reflects income.

Section 1.446-1(c)(1)(iii) of the regulations states that the installment method is a permissible method and cross-references section 453 of the Code.

The Installment Sales Revision Act of 1980, P.L. 96-471, 1980-2 C.B. 489, continued the existing law under section 453 of the Code with respect to dealers in personal property by adding section 453A of the Code. Section 453A(a)(1) and section 1.453-1(a) of the regulations provide that a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any tax year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.

The provisions of section 1.1502-13 of the regulations set forth the general rules for intercompany transactions, including the sale or exchange of property, such as installment obligations, between members of the same consolidated group. In accordance with the specific language of section 1.1502-17(a), however, it is necessary first to determine whether the initial sale of merchandise by *P* under its arrangement with *BK* qualifies as an installment sale under section 453A and second, whether *P* has sold *BK* its installment obligations under section 1001, before the intercompany transaction provisions set forth in section 1.1502-13 can apply.

With respect to the first consideration, section 453(A) of the Code specifically allows dealers in personal property, that is, persons who regularly sell or otherwise dispose of personal property on the installment plan, to return the income from these sales on the installment method. Whether a dealer is regularly selling on the installment basis is determined by several factors, such as the number and frequency of installment sales made throughout the year, the ratio or proportion between installment sales and total sales, the period over which the installment sales are made and the general holding out to the public that such arrangements could be made. *Davenport Machine & Foundry Co. v. Commissioner*, 18 T.C. 39 (1952), *acq.*, 1952-2 C.B. 1; *Louis Greenspon v. Commissioner*, 23 T.C. 138 (1954), *aff'd* and *rev'd* on other grounds, 229 F.2d 947 (8th Cir. 1956).

In the instant situation, *P*'s selling practice within its own separate trade or business, rather than its arrangement with *BK*, is controlling to determine whether *P* regularly sells on the installment plan. Since *P* does not offer installment terms with respect to any items it sells throughout the year, the factors of frequency of installment sales, number of installment sales throughout the year and the general holding out to the public do not apply and *P* cannot be considered as selling on the installment basis. The fact that *BK*, a member of *P*'s consolidated group, advances credit to *P*'s customers does not alter the determination that section 453A of the Code does not apply to *P*'s sales. Each member of the consolidated group must determine its method of accounting as if it filed a separate return. *BK* would not be entitled to use the installment method because it is not a dealer in personal property. *See* section 1.1502-17 of the regulations and section 453A of the Code.

Generally, a seller is required to extend credit initially to its customers in order to be eligible for installment reporting. An exception to this general rule has been made in the case of an agent of the seller that extends credit to the seller's customers. *See* Rev. Rul. 76-269, 1976-2 C.B. 129, for example, in which the seller of condominium units is allowed to report income on the installment method even though a mortgage company acting as the seller's agent extends credit to the purchasers in the form of notes which the seller is obligated to purchase immediately following the making of each loan.

In the present situation, *BK* is operating as a separate and distinct entity within *P*'s consolidated group, *P* is fully paid by *BK* for the merchandise *P* sells to its credit customers, *P* is under no obligation to buy the installment obligation from *BK* immediately after the sale and *P* does not bear any risk of loss upon possible default of the credit customer. Accordingly, the exception set forth in Rev. Rul. 76-269 does not apply for *P*. Therefore, *P*'s initial sale of merchandise to its credit customers does not qualify for installment sale treatment.

With respect to the second consideration, there has been no sale or exchange of property between *P* and *BK*. The fact that *P* could have structured its arrangement with *BK* differently by regularly selling its merchandise on the installment plan and then selling the resulting installment obligations to *BK* does not alter this determination . In the instant situation, there has been no sale or exchange of property between *P* and *BK* within the meaning of section 1001 of the Code, as required by section 1.1502-13(a)(2) of the regulations,

and no series of hypothetical intermediate transactions are sufficient to satisfy the requirement of a sale or exchange when none has taken place. *See*, for example, *Hummel v. Commissioner*, T.C.M. 1970-341, and *Giberson v. Commissioner*, T.C.M. 1982-338, in which it was held that the form in which the taxpayer casts a transaction, and not a hypothetical series of transactions, controls for tax purposes, unless what occurred in substance differed from what the form indicates.

HOLDING

Under the circumstances described above, *P* may not treat, for federal income tax purposes, the extension of credit by *BK* to *P*'s customers and the sale of merchandise by *P* to these same credit customers as equivalent to *P* selling on the installment basis to its customers and then selling the installment obligations in a deferred intercompany transaction to *BK*.

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26 CFR 1.1502-25: consolidated section 922 deduction.
(Also Section 1503; 1.1503-1.)

Consolidated returns; Western Hemisphere trade corporations. Under certain circumstances the Service will no longer require application of the fractional method without losses set forth in section 1.1502-25(c) of the regulations for purposes of determining the "portion of the consolidated taxable income" attributable to those members of an affiliated group that are Western Hemisphere trade corporations (WHTCs).

Rev. Rul. 85-136

The Internal Revenue Service will no longer litigate the issue considered by the United States Court of Claims in *American Standard, Inc. v. United States*, 602 F.2d. 256 (Ct. Cl. 1979), *Union Carbide Corporation v. United States*, 612 F.2d 558 (Ct. Cl. 1979), and *Allied Corporation v. United States*, 685 F.2d 396 (Ct. Cl. 1982). Specifically, the Service will no longer require application of the fractional method without losses set forth in section 1.1502-25(c) of the Income Tax Regulations for purposes of determining the "portion of the consolidated taxable income" attributable to those members of an affiliated group filing a consolidated return that are Western Hemisphere trade corporations (WHTCs). Such "portion of the consolidated taxable income" must be determined for purposes of computing the consolidated section 922 deduction, now repealed, under section 1.1502-25, and the foreign tax credit reduction under section 1503(b)(1) of the Internal Revenue Code, also now repealed.

The court in *American Standard* declared invalid the last sentence of section 1.1502-25(c)(2) of the regulations, which requires the exclusion of loss members of an affiliated group filing a consolidated return from a formula used to determine the portion of consolidated taxable income attributable to those members of a consolidated group that qualify as Western Hemisphere Trade Corporations (WHTCs) under repealed section 921 of the Code. Under section 1.1502-25(c) of the regulations, it is necessary to determine the portion of consolidated taxable income attributable to WHTCs in order to calculate the amount of the consolidated section 922 deduction allowed against income of the WHTCs. The taxpayer's method of computing the consolidated section 922 deduction on its return was to include loss members in the fraction used to compute the portion of consolidated taxable income attributable to WHTCs, in order to calculate the amount of the consolidated section 922 deduction allowed against income of the WHTCs.

The court in *Union Carbide Corporation* declared the last sentence of section 1.1502-25(c)(2) of the regulations to be invalid for purposes of computing the foreign tax credit reduction required by repealed section 1503(b)(1) of the Code for affiliated groups with WHTC members. Although the court agreed with the Government that the phrase "portion of consolidated taxable income attributable to such [Western Hemisphere trade] corporation" in section 1503(b)(1) has the same meaning as it does in section 1.1502-25 of the regulations, the court held that the method of computing such amount for purposes of the consolidated section 922 deduction upheld in *American Standard* also applied to computing the foreign tax credit reduction required by section 1503(b)(1).

In *Allied Corporation* the court considered three cases, all of which involved the proper method of computing the section 922 deduction granted WHTCs when consolidated returns are filed. The court reaffirmed its decision in *American Standard*, and as to one of the taxpayers it held that the appropriate method by which a WHTC's net operating losses were to be carried back was the method found in section 1.1502-79(a) of the regulations.

In light of the fact that these cases were decided in a court of national jurisdiction and that the statutory provisions have been repealed, the Service will follow these decisions, in cases presenting the same facts, and subject to the conditions set forth herein, as a basis for disposing of this issue in determining the consolidated section 922 deduction, as well as the section 1503(b)(1) foreign tax credit reduction.

The *American Standard* opinion rejected the Service's argument that the fractional method with losses was unreasonable because it permitted "the portion of consolidated taxable income attributable to" the WHTCs to be greater than the whole. In so doing, the *American Standard* opinion relied by analogy on section 1.1502-27 of the regulations, stating that:

Under the *aggregate method with losses*, the "portion of the consolidated taxable income" attributable to the corporation to which the deduction is given by section 922 or section 247 is the actual net taxable income contributed by the group, and, therefore, can be greater than actual consolidated taxable income. Defendant's argument questions, in effect, the reasonableness of section 1.1502-27. We conclude, however, that utilizing the actual net taxable income of the subgroup for which the deduction is intended, complies fully with section 922, section 247, and the consolidated return statutes.

The phrase "portion of the consolidated taxable income" is not found in section 1.1502-27 of the regulations, as it is in section 1.1502-25 and section 1503(b)(1) of the Code. Moreover, in the *American Standard* case (and the Court of Claims cases following *American Standard*), the consolidated taxable income was in fact greater than the portion of the consolidated taxable in-

come determined to be attributable to the WHTCs. Accordingly, the quoted statement was dictum, and it is the Service's position that it is erroneous.

Although the Service will follow *American Standard, Union Carbide* and *Allied Corporation* in cases having the same factual pattern as the decided cases, the Service will adhere to its position that the portion of the consolidated taxable income attributable to the members of the affiliated group that are WHTCs cannot exceed the total consolidated taxable income.

The Service will not take adverse action against those taxpayers who have relied upon, and consistently applied, section 1.1502-25(c) of the regulations. However, a taxpayer will not be permitted to choose from year to year either the method prescribed in section 1.1502-25(c) or the method approved in this ruling, whichever is more favorable.

Section 1503.—Computation and Payment of Tax

26 CFR 1.1503-1: Computation and payment of tax.

Computation of the foreign tax credit reduction under section 1503(b)(1) of the Code (now repealed) for Western Hemisphere trade corporations when consolidated returns are filed. See Rev. Rul. 85-136, page 194.

Subtitle B.—Estate and Gift Taxes
Chapter 11.—Estate Tax
Subchapter A.—Estate of Citizens or Residents
Part I.—Tax Imposed

Section 2001.—Imposition and Rate of Tax

T.D. 8044

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER B, SUBCHAPTER H, PART 27—TEMPORARY ESTATE, GIFT AND GENERATION-SKIPPING TRANSFER TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1984; PART 602—REPORTING AND RECORDKEEPING REQUIREMENTS

Reports of Transfers of Public Housing Bonds

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary estate, gift and generation-skipping transfer tax regulations relating to the reporting requirements for certain transfers of public housing bonds under the Tax Reform Act of 1984 [1984-3 C.B. (Vol. 1) 1]. The regulations provide Internal Revenue Service personnel who administer the Internal Revenue Code and members of the public with the guidance necessary to comply with the law.

DATES: The regulations apply to transfers of public housing bonds made after December 31, 1983, and before June 19, 1984.

FOR FURTHER INFORMATION CONTACT: Fred E. Grundeman of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains temporary estate, gift and generation-skipping transfer tax regulations relating to certain reporting requirements involving public housing bonds. These amendments reflect section 642 of the Tax Reform Act of 1984 (the 1984 Act) (Pub. L. 98-369, 98 Stat. 939). This document adds a new Part 27, Temporary Estate, Gift and Generation-Skipping Transfer Tax Regulations under the Tax Reform Act of 1984, to Title 26 of the Code of Federal Regulations.

TRANSFERS OF PUBLIC HOUSING BONDS

In *Haffner v. United States*, 585 F. Supp. 354, affd. 757 F. 2nd 920, it was held that the value of public housing bonds issued under section 11(b) of the Housing Act of 1937 is not includible in a decedent's gross estate and thus the bonds are exempt from Federal estate tax. Section 641 of the 1984 Act clarifies that transfers of such bonds made after June 18, 1984, are subject to Federal estate, gift and generation-skipping transfer tax. Section 642(a) of the 1984 Act requires that taxpayers who transfer such bonds after December 31, 1983, and before June 19, 1984, must report the amount and date of such transfers so that a determination of the tax and interest due can be made if it is ultimately determined that such transfers are subject to tax. Section 642(b) of the 1984 Act provides that a taxpayer who fails to provide the information required to be reported under section 642(a) and such regulations as are prescribed will be liable for a penalty. The amount of the penalty shall be 25 percent of the additional gift, estate or generation-skipping transfer tax that would be payable if such transfers were subject to tax. The regulation requires that in order to avoid the penalty such reports must be made, on the appropriate Federal tax form, by the later of (1) the due date for the tax return covering the period when the transfer was made (including extensions); or (2) December 31, 1985.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this temporary regulation is not a major rule as defined in Executive Order 12291. Accordingly, a regulatory impact analysis is not required.

A general notice of proposed rulemaking is not required by 5 U.S.C. 553(b) for temporary regulations. Accordingly, the temporary regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

PAPERWORK REDUCTION ACT

The collection of information requirements contained in this regulation have been submitted to OMB for review under the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these regulations is Fred E. Grundeman, of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, a new Part 27, Temporary Estate, Gift and Generation-Skipping Transfer Tax Regulations under the Tax Reform Act of 1984 is added to Title 26 of the Code of Federal Regulations, and 26 CFR Part 602 is amended as follows:

Paragraph 1. A new Part 27 is adopted as set forth below.

PART 27—TEMPORARY ESTATE, GIFT AND GENERATION-SKIPPING TRANSFER TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1984.

Sec. 27.642-1 Reports of transfers of public housing bonds.

Authority: 26 U.S.C. 7805; §27.642-1 also issued under 26 U.S.C. 2001, note, Pub. L. 98-369, §642.

§27.642-1 Reports of transfers of public housing bonds.

(a) *In general.* If a donor or a decedent transfers bonds issued under section 11(b) of the United States Housing Act of 1937 (public housing bonds) after December 31, 1983, and before June 19, 1984, the taxpayer shall report the date and amount of such transfer in the time and manner provided in this section.

(b) *Manner of reporting*—(1) *Transfers from decedents.* The fair market value of public housing bonds transferred by a decedent dying after December 31, 1983, and before June 19, 1984, that are not reported for Federal estate tax purposes as part of the total value of the gross estate of the decedent shall be reported (along with sufficient information to identify the type of bonds) by the executor of the estate on Form 706 (or 706NA), United States Estate Tax Return, or on a statement attached to such return.

(2) *Transfers from donors.* The fair market value of public housing bonds transferred for less than full and adequate consideration in money or money's worth after December 31, 1983, and before June 19, 1984, that are not reported as part of the total amount of gifts made by a donor during the calendar year 1984 shall be reported by the donor along with the date of the transfer (and sufficient information to identify the type of bonds) on Form 709 (or Form 709A), United States Gift Tax Return, or on a statement attached to such return.

(3) *Generation-skipping transfers.* The fair market value of public housing bonds transferred in a generation-skipping transfer (as defined in section 2611(a)) occurring after December 31, 1983, and before June 19, 1984, and not reported as a generation-skipping transfer under chapter 26 of the Internal Revenue Code of 1954 shall be reported by the trustee of the generation-skipping trust (or trust equivalent) along with the date of the transfer (and sufficient information to identify the type of bonds) on form 706-B, Generation-skipping Transfer Tax Return, or on a statement attached to such return.

(c) *Time for reporting.* If a taxpayer must report transfers of public housing bonds as provided in paragraph (b) of this section, the date and amount of such transfer shall be disclosed in an appropriate schedule on the appropriate return or in a statement attached to the return on or before the later of (1) the due date of the return (including extensions); or (2) December 31, 1985. If the taxpayer has previously filed Form 709, 709A or 706B without reporting such transfers the taxpayer shall file an amended Form disclosing the transfer. Where the executor of an estate has previously filed Form 706 or 706NA without reporting such transfers the executor must file a statement reporting the required information along with a copy of the first page of the previously filed return for association with that return.

(d) *Penalty for failure to report.* Except as provided below, any taxpayer failing to provide the amount and date of any transfer of public housing bonds as required in this section shall be liable for a penalty equal to 25 percent of the excess of (1) the estate tax, the 1984 gift tax, or the 1984 generation-skipping transfer tax that would be payable assuming such transfers are subject to tax, over (2) the applicable tax payable assuming such transfers are not subject to tax. This section shall not apply to any taxpayer if the total value of the taxpayer's transfers (including the value of the public housing bonds) is less than the minimum filing requirement for the appropriate Federal transfer tax return.

Par. 2. The authority citation for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 3. Section 602.101(c) is amended by inserting in the appropriate place in the table:

"§27.642-1 1545-0020"

There is need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved July 19, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 7, 1985, 8:45 a.m., and published in the issue of the Federal Register for August 8, 1985, 50 F.R. 32010)

Part II.—Credits Against Tax

Section 2013.—Credit for Tax on Prior Transfers

26 CFR 20.2013-4: Valuation of property transferred.

Credits against tax; prior transfers; valuation; termination of life interest upon remarriage. A remarriage contingency will not result in disallowance of the credit for tax or prior transfers. It is a valuation factor to be taken into account in determining the value of the income interest transferred.

Rev. Rul. 85-111

ISSUE

Does the contingency of termination of a life income interest upon remarriage require disallowance of the credit for tax on prior transfers under section 2013 of the Internal Revenue Code?

FACTS

D received a life income interest in a trust created under the will of *D*'s spouse *S* who died in 1980. The trust provided that *D* was to receive all the net income of the trust, in quarter-annual installments, until *D*'s death or

remarriage, whichever occurred first. This income interest did not qualify for the marital deduction in *S*'s estate; consequently, part of the federal estate tax paid by *S*'s estate was attributable to the life income interest. *D* died in 1984.

LAW AND ANALYSIS

Section 2013 of the Code provides for allowance of a credit against the federal estate tax of a present decedent for the federal estate tax paid on the transfer of property to the present decedent from another decedent who died within ten years before, or two years after, the present decedent's death. Section 20.2013-4 of the Estate Tax Regulations provides that the value of the property transferred to the present decedent is the value used for purposes of determining the federal estate tax of the prior decedent (taking into account the effect of any death taxes, encumbrances, and any marital or charitable deduction allowed).

Section 2013 of the Code requires that the credit for tax or prior transfer is available only if the transferee's interest is susceptible of valuation as of the date of the transferor's death. Section 20.2013-4 of the regulations.

If the flow of income to a life income transferee is subject to interruption through the exercise of a trustee's uncontrolled discretion, the transferee beneficiary's interest cannot be valued according to recognized valuation methods. Rev. Rul. 67-53, 1967-1 C.B. 265, holds that under such circumstances, since the transferee beneficiary's interest is not susceptible of valuation as of the date of the transferor's death, the credit for tax on prior transfers under section 2013 is not allowable, notwithstanding that such income was actually paid to the transferee. *See also Estate of Wraith v. United States*, 575 F.2d 1288 (9th Cir. 1978), which held that because of broad discretionary powers of the trustees, a life income interest was incapable of valuation under recognized valuation principles for purposes of section 2013.

The possibility of termination of a survivor's annuity upon the remarriage of the annuity beneficiary is taken into account as a valuation factor in determining the value of the annuity includible in a decedent's gross estate under section 2039 of the Code. Rev. Rul. 74-557, 1974-2 C.B. 301. Thus, a remarriage contingency in these circumstances does not render a lifetime interest incapable of valuation for purposes of sections 2039 or 2013 of the Code.

HOLDING

The contingency of termination of a life income interest upon remarriage does not require disallowance of the credit for tax on prior transfers under section 2013 of the Code. The remarriage contingency is a valuation factor to be taken into account in determining the value of the income interest transferred.

Part III.—Gross Estate

Section 2032.—Alternate Valuation

26 CFR 20.2032-1: Alternate valuation.

Whether an annuity qualifies for the marital deduction under section 2056(a) of the Code, if another person's contingent interest therein will be extinguished before the alternate valuation date under section 2032 of the Code. See Rev. Rul. 85-100, page 200.

Section 2032A.—Valuation of Certain Farm, etc., Real Property

Valuation; special use. For purposes of the 25 percent test of section 2032A(b)(1)(B) of the Code, the aggregation of the adjusted value of real estate in different businesses is allowable and, for purposes of the 50 percent test of section 2032A(b)(1)(A), aggregation of the adjusted value of personalty is allowable if associated with real estate that otherwise meets the requirements of that test.

Rev. Rul. 85-168

ISSUE

Under the circumstances below, may a decedent's estate combine the adjusted values of property used in more than one trade or business for purposes of meeting the requirements of section 2032A(b)(1)(A) and (B) of the Internal Revenue Code?

FACTS

D, a citizen of the United States, died in 1984 owning a parcel of real estate located in state *X*. At the time of D's death, *D* was using the real estate as a farm for farming purposes and had owned and operated the farm for more than ten years immediately preceding that time. The adjusted value (as defined in section 2032A(b)(3) of the Code) of the real estate comprised 20 percent of the adjusted value of *D*'s gross estate. The adjusted value of the personal property devoted to farming use on the farm comprised 10 percent of the adjusted value of *D*'s gross estate.

On the date of *D*'s death, *D* also owned a building located in state *X*. At that time, *D* was using the building in a business other than farming. *D* had owned the building for a period of more than ten years preceding *D*'s death. At all times during that period, *D* used the building in the business and personally operated the business. The adjusted value of the building was 22 percent of the adjusted value of *D*'s gross estate.

Under *D*'s will, both the farm and the building passed to qualified heirs within the meaning of section 2032A of the Code.

LAW AND ANALYSIS

Section 2032A(a) of the Code provides that if the decedent was (at the time of the decedent's death) a citizen or resident of the United States and the executor elects the application of section 2032A and files the agreement referred to in section 2032A(d)(2), then, for purposes of the federal estate tax, the value of qualified real property will be its value for the use under which it qualifies, under section 2032A(b), as qualified real property. The aggregate decrease in the value of qualified real property which results from the application of section 2032A(a) with respect to any decedent may not exceed $750,000.

Section 2032A (b)(1) of the Code defines the term "qualified real property" to mean real property located in the United States which was acquired from or passed from the decedent to a qualified heir of the decedent and which, on the date of the decedent's death, was being used for a qualified use by the decedent or a member of the decedent's family, but only if—

(A) 50 percent or more of the adjusted value of the gross estate consists of the adjusted value of real or personal property which, on the date of the de-

cedent's death, was being used for a qualified use by the decedent or a member of the decedent's family, and was acquired from or passed from the decedent to a qualified heir of the decedent;

(B) 25 percent or more of the adjusted value of the gross estate consists of the adjusted value of real property which was acquired from or passed from the decedent to a qualified heir and which meets the requirements of section 2032A(b)(1)(C);

(C) during the 8-year period ending on the date of the decedent's death there were periods aggregating 5 years or more during which the real property was owned by the decedent or a member of the decedent's family and there was material participation by the decedent or a member of the decedent's family in the operation of the farm or other business; and

(D) the real property is designated in the agreement referred to in section 2032A(d)(2).

Section 2032A(b)(2) of the Code defines the term "qualified use" to mean the devotion of the property to any of the following: (A) use as a farm for farming purposes, or (B) use in a trade or business other than the trade or business of farming.

Section 2032A(b)(3) of the Code defines the term "adjusted value" to mean (A) in the case of the gross estate, the value of the gross estate for federal estate tax purposes (determined without regard to section 2032A), reduced by any amount allowable as a deduction under section 2053(a)(4) (relating to unpaid mortgages, etc.) or (B) in the case of any real or personal property, the value of the property (determined without regard to section 2032A), reduced by any amounts allowable as a deduction in respect of that property under section 2053(a)(4).

In the instant case, the real property used as a farm, the personal property used in farming operations, and the building passed to qualified heirs within the meaning of section 2032A of the Code. All the property, real and personal, was being used by *D* for a qualified use (as defined in section 2032A(b)(2)) on the date of *D*'s death. In addition, both the real estate used as a farm and the building were owned continuously by *D* and were used for a qualified use by *D* for at least five years during the eight-year period ending on the date of *D*'s death, and *D* had personally operated the farm and other business during that time. Therefore, if the adjusted value of the real estate used as a farm may be combined with the adjusted value of the building, then the requirements of section 2032A(b)(1)(B) are met since the combined adjusted value of the real property equals 42 percent of the adjusted value of *D*'s gross estate. Likewise, if the adjusted value of the real property used as a farm and the personal property used in farming operations may be combined with the adjusted value of the building, then the requirements of section 2032A(b)(1)(A) are met since the combined adjusted value of the real and personal property equals 52 percent of the adjusted value of *D*'s gross estate.

In *Estate of Geiger* v. *Commissioner*, 80 T.C. 484 (1983), the decedent died owning real estate used as a farm for farming purposes. The decedent also owned and operated a hardware business on leased real estate. The adjusted value of the farm, including personal property associated with the farm, was 42 percent of the adjusted value of the decedent's gross estate. The adjusted value of the farm property combined with the adjusted value of the personal property of the hardware business was 53 percent of the adjusted value of the gross estate. The court held that the adjusted value of the personal property of the hardware business could not be taken into account in determining whether the 50 percent test set forth in section 2032A(b)(1)(A) of the Code was met. The court believed that Congress did not intend section 2032A(b)(1)(A) to include personal property that was unconnected with real property that was being used for a qualifying use.

In the instant case, however, the personal property is connected with real property that meets the requirements of section 2032A(b)(1)(A) of the code. Thus, *Estate of Geiger* is distinguishable from the instant case. *D*'s estate may therefore combine the adjusted value of the personal property used for farming with the adjusted value of real property used in farming or in a separate trade or business for purposes of meeting the 50 percent requirement of section 2032(b)(1)(A) because the personal property is connected with qualifying real estate in the same enterprise.

HOLDING

For purposes of section 2032A(b)(1)(A) of the Code, *D*'s estate may combine the adjusted value of the real property used as a farm and personal property used in farming operations with the adjusted value of the building used in the separate business. Likewise, for purposes of section 2032A(b)(1)(B), the adjusted value of the real property used as a farm may be combined with the adjusted value of the building.

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26 CFR 20.2032A-4: Method of valuing farm real property.

Special use value; farms; interest rates. The interest rates to be used in computing the special use value of farm real property for which an election is made under section 2032A of the Code are listed. The rates may be used by estates that value farmland under section 2032A as of a date in 1985.

Rev. Rul. 85-92

This revenue ruling contains a list of the average annual effective interest rates on new Federal Land Bank loans. Under section 2032A(e)(7)(A)(ii) of the Internal Revenue Code, rates on new Federal Land Bank loans are used in computing the special use value of real property used as a farm for which an election is made under section 2032A. This revenue ruling also contains a list of the states within each land bank district. The rates in this revenue ruling may be used by estates that value farmland under section 2032A as of a date in 1985.

Average annual effective interest rates (appearing at the top of page 199), calculated in accordance with section 2032A(e)(7)(A) of the Code and section 20.2032A-4(e) of the Estate Tax Regulations, are to be used under section 2032A(e)(7)(A)(ii).

Rev. Rul. 81-170, 1981-1 C.B. 454, which sets forth rates for several prior years, contains an illustrative computation of an average annual effective interest rate. The rates applicable in the case of valuations for 1982 are listed in Rev. Rul. 82-104, 1982-1 C.B. 129.

The rates applicable in the case of valuations for 1983 are listed in Rev. Rul. 83-71, 1983-1 C.B. 227, and for valuations in 1984 in Rev. Rul. 84-119, 1984-2 C.B. 193.

Federal Land Bank District in which property is located	Year of valuation 1985
Baltimore	12.60
Columbia	11.69
Texas (Formerly Houston)	11.41
Louisville	12.27
Jackson (Formerly New Orleans)	11.94
Omaha	12.45
Sacramento	11.92
St. Louis	12.44
St. Paul	11.98
Spokane	12.12
Springfield	11.73
Wichita	12.41

Federal Land Bank District: District	States
Baltimore	Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, West Virginia.
Columbia	Florida, Georgia, North Carolina, South Carolina
Texas	Texas
Lousiville	Indiana, Kentucky, Ohio, Tennessee
Jackson	Alabama, Louisiana, Mississippi
Omaha	Iowa, Nebraska, South Dakota, Wyoming
Sacramento	Arizona, California, Hawaii, Nevada, Utah
St. Louis	Arkansas, Illinois, Missouri
St. Paul	Michigan, Minnesota, North Dakota, Wisconsin
Spokane	Alaska, Idaho, Montana, Oregon, Washington
Springfield	Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, Vermont
Wichita	Colorado, Kansas, New Mexico, Oklahoma

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26 CFR 20.2032A-8. Election and agreement to have certain property valued under section 2032A for estate tax purposes.

Special use valuation; election and agreement; perfection. An executor may perfect an election to specially value qualifying real property under section 2032A of the Code, where the only imperfection is the failure to sign the agreement by the spouse who has only an inchoate dower interest.

Rev. Rul. 85-148

ISSUES

Are the requirements for electing special use valuation of qualified real property under section 2032A of the Internal Revenue Code satisfied if a spouse of an heir to whom the property is devised has an inchoate dower interest and has not signed the agreement required to be filed under section 2032A(a)(1)(B)?

May an estate perfect a section 2032A election that is incomplete because a spouse who has no more than an inchoate dower interest in the qualified real property has not signed the agreement required under section 2032A(a)(1)(B)?

FACTS

D died on February 1, 1984, survived by three adult children, *A*, *B*, and *C*, all qualified heirs within the meaning of section 2032A(e)(1) of the Code. At the time of *D*'s death *B* and *C* were married. Included in *D*'s estate were three separate parcels of farm land that had been actively farmed by *D* for several years. Parcel I was devised to *A*, Parcel II to *B*, and Parcel III to *C*. The executor of *D*'s estate filed an estate tax return on November 1, 1984, and attempted to elect special use valuation for the three parcels of farm land under section 2032A. Under the facts in this case, in order to satisfy the percentage requirements set forth in section 2032A(b)(1) for qualified real property, all three parcels together must be specially valued. The executor attached to the return the notice of election to specially value all three parcels of property and the agreements described in section 2032A(d) of the Code. The notice of election contained all the required information, and the agreements had been signed by *A*, *B*, and *C*. However, the executor did not have the wife of *B* or the husband of *C* sign the agreements that were signed by *B* and *C*, re-

spectively. All other information necessary to qualify for special use valuation was filed with the estate tax return. Under State *X* law the spouse of *B* had an inchoate dower interest in the property by reason of the interest devised to *B*. In order to convey marketable title, it would be necessary for *B*'s spouse to consent to the sale of the property and sign the deed. However, State *X* law provides no dower, curtesy, or similar interest for *C*'s huband in the property devised to *C*.

Shortly after filing the estate tax return, the executor was advised by the Internal Revenue Service that, because *B*'s agreement had not been signed by *B*'s spouse, the estate had not complied with all the requirements for electing special use valuation. Upon learning of the problem, the executor promptly obtained the signature of *B*'s spouse and filed the corrected agreement with the Service.

LAW AND ANALYSIS

Section 2032A of the Internal Revenue Code provides that real property used on a farm may be included in the decedent's gross estate at its value for use as a farm rather than at its fair market value.

Section 2032A(a)(1)(B) of the Code provides that, to receive this benefit, the executor must elect the application of special use valuation and must file the agreement described in section 2032A(d)(2) of the Code.

Section 2032A(d)(2) requires that the agreement be in writing and signed by each person who has an interest in the property to be specially valued. Under the agreement, all interested parties consent to the imposition of an additional estate tax if the qualified heir disposes of any interest in the specially valued property or ceases to use the property as a farm for farming purposes within a designated period of the decedent's death.

Section 2032A(d)(3) allows the executor a reasonable period of time (not exceeding 90 days after notification) to perfect an election or agreement that does not include all the required information. However, the notice of election must have initially been attached to the estate tax return, and the estate must have substantially complied with the requirements for electing special use valuation.

Section 20.2032A-8(c) of the Estate Tax Regulations requires that all parties who have any interest in the property being specially valued execute an agreement required under section 2032A(d)(2). An interested party is described as a person in being at the death of the decedent who has any interest in the property, whether present or future, or vested or contingent, which, as of the date of the decedent's death, can be asserted under applicable local law so as to affect the disposition of the specially valued property by the estate.

Under the laws of State *X*, the spouse of *B* had an inchoate dower interest in Parcel II, which could affect a disposition by the estate of that property with marketable title. However, applicable state law provided *C*'s spouse with no assertable interest in Parcel III. The attempted election filed by the estate to specially value the three parcels was not complete as filed because *B*'s agreement included with the estate tax return was not signed by the spouse of *B*.

The notice of election and the agreements executed by *A*, *B*, and *C* were attached to the estate tax return. All the requirements for a complete agreement for Parcel I and Parcel III were satisfied. The requirements for a complete agreement for Parcel II were satisfied except for the failure of the executor to have *B*'s spouse sign *B*'s agreement. Because the interest of *B*'s spouse was merely an inchoate dower interest, the requirements for electing special use valuation for Parcel II were substantially complied with and the agreement may be perfected within a reasonable period of time not to exceed 90 days after notification by the Service. After learning of the need for an additional agreement, the executor filed the agreement by *B*'s spouse promptly, in an attempt to fully comply with the election requirements.

HOLDING

The requirements for electing special use valuation of qualifying real property under section 2032A of the Code are not satisfied by the executor of the decedent's estate where a spouse of an heir to whom the property is devised has an inchoate dower interest and has not signed the agreement required under section 2032A(a)(1)(B).

An election whose only imperfection is the failure to obtain the signature on the required agreement of a spouse who has no more than an inchoate dower interest in the qualifying real property that was devised to a qualified heir substantially complies with the regulations within the meaning of section 2032A(d)(3)(B). Accordingly, the executor may perfect the election because it was filed with the estate tax return and substantially complied with the requirements of section 2032A and the regulations thereunder.

Section 2039.—Annuities

26 CFR 20.2039-1: Annuities.

Whether an annuity qualifies for the marital deduction under section 2056(a) of the Code, if another person's contingent interest therein will be extinguished before the alternate valuation date under section 2032 of the Code. See Rev. Rul. 85-100, below.

Part IV.—Taxable Estate

Section 2056.—Bequests, Etc., To Surviving Spouse

26 CFR 20.2056(b)-1: Marital deduction; limitation in case of life estate or other "terminable interest".
(Also Sections 2032, 2039; 20.2032-1, 20.2039-1.)

Marital deduction; alternate valuation date; contingent interest. A surviving spouse's interest in property will not qualify for the marital deduction where another party has an interest in the property on the decedent's date of death but that interest is extinguished prior to the alternate valuation date as elected by the executor of the decedent's estate.

Rev. Rul. 85-100

ISSUE

Does an employee death benefit annuity qualify for the marital deduction under section 2056(a) of the Internal Revenue Code, if another person's contingent interest therein will be extinguished before the alternate valuation date of section 2032 of the Code?

FACTS

Decedent, *D* died on February 1, 1983, survived by a spouse, *S*, and a minor child, *C*. Prior to *D*'s death, *D* had the right to receive annuity pay-

ments for life. Under the terms of the annuity contract, at *D*'s death the payments would continue to *S* for life. If *S* died leaving minor children, the payments would continue to the minor children until the last surviving child of *D* and *S* reached age 18, at which time any remaining excess of the cost of the contract over the annuity payments already made would be refunded to the surviving children. If *S* died leaving no surviving minor children, the excess, if any, was to be refunded to *S*'s estate. *C* reached age 18 on June 5, 1983. Thus, had *S* died prior to June 5, 1983, *C* would have been entitled to payments on the annuity (and refund of the excess of the contract cost over the annuity payments). Because *S* survived until June 5, 1983, *S* became entitled to receive all of the payments of the annuity until *S*'s death and to have the excess of the cost of the contract over the sum of the annuity payments distributed to *S*'s estate.

The executor timely filed the estate tax return on November 1, 1983, and elected to value all the property included in *D*'s gross estate as of August 1, 1983, the alternate valuation date. No election was made to treat any property in *D*'s estate as qualified terminable interest property.

LAW AND ANALYSIS

Section 2032(a) of the Code states that the value of a decedent's gross estate may be determined, if the executor so elects, by valuing all the property included in the gross estate as of the date six months after the decedent's death for property which has not been distributed, sold, exchanged, or otherwise disposed of prior to that date (commonly referred to as the "alternate valuation date"). Under section 2032(a)(3), if such an election is made, any interest affected by a mere lapse of time will be included at its date of death value (instead of the alternate valuation date) with adjustment for any difference in its value as of the alternate valuation date not due to mere lapse in time.

Section 2056(a) of the Code allows a deduction from the value of the gross estate of the value of certain property interests that are included in the decedent's gross estate and that pass from the decedent to the surviving spouse.

Under section 2056(a)(1), however, no deduction is allowed for any property interest that passes to the surviving spouse and that may terminate or fail on the lapse of time or the occurrence or the failure to occur of some contingency, if (i) another interest in the same property has also passed from the decedent to some other person for less than an adequate and full consideration in money or money's worth, and (ii) by reason of the passing of such interest, such other person may possess or enjoy any part of the property after the termination of the spouse's interest.

Whether a property interest meets the requirements of section 2056(b) of the Code must be determined in light of events at the time of the decedent's death. *Allen v. United States*, 359 F.2d 151, 154 (2d Cir. 1966), *cert. denied*, 385 U.S. 832 (1966). See *Shedd's Estate v. Commissioner*, 237 F.2d. 345, 350-351 (9th Cir. 1956), *cert. denied*, 352 U.S. 1024 (1957). An election to value all property included in the gross estate as of the alternate valuation date under section 2032 does not affect the determination of whether a property interest meets the requirements of section 2056(b). Section 2032(b) provides that no deduction from the gross estate shall be allowed for any item if allowance of that item is in effect given by selection of the alternate valuation date under section 2032. With respect to the marital deduction, Senate Report No. 1013 (Part 2), 80th Cong., 2d Sess. 10 (1948), 1948-1 C.B. 338, states:

> The election of the executor to determine the value of the gross estate as of a date subsequent to the decedent's death, as provided in section 811(j) of the Code [the Internal Revenue Code of 1939, the predecessor to section 2032 of the Internal Revneue Code of 1954], does not extend to such later date the time for determining the character of the interest passing to the surviving spouse and its deductibility under [section 812(e)(1)(B) of the 1939 Code, the predecessor to section 2056(b) of the 1954 Code]. Section 811(j) relates only to valuation and applies only with respect to interests at the date of the decedent's death. . . .

In this case, the annuity received by *S* at *D*'s death constituted a terminable interest. Moreover, at the date of *D*'s death, *C* had a contingent right to the annuity payments if *S*, the surviving spouse, should die before *C* reached 18 years of age. Because *C* received an interest in the annuity at *D*'s death and could enjoy the interest after the termination of *S*'s interest, at *D*'s death *S*'s interest is a nondeductible terminable interest as described in section 2056(b) of the Code.

Therefore, as of the date of *D*'s death, the value of the annuity passing to *S* (to the extent includible in *D*'s gross estate) does not qualify for the marital deduction under section 2056(a) of the Code.

If *D* had died after *C* had reached age 18, the value of the annuity which passed to *S* would have been a deductible terminable interest under section 2056(a) of the Code because no other person would have had a right to possess or enjoy the property after the termination of *S*'s interest.

HOLDING

The value of the annuity does not qualify for the marital deduction under section 2056 of the Code, even though another person's contingent interest will be extinguished before the alternate valuation date under section 2032, as elected by the decedent's estate.

Chapter 12.—Gift Tax
Subchapter B.—Transfer

Section 2511.—Transfers in General

26 CFR 25.2511-1: Transfers in general.

Procedures are set forth for the valuation and reporting requirements for gifts resulting from low-interest and interest-free demand loans outstanding during 1984 and prior years. See Rev. Proc. 85-46, page 507.

Section 2512.—Valuation of Gifts

26 CFR 25.2512-1: Valuation of property; in general.

Procedures are set forth for the valuation and reporting requirements for gifts resulting from low-interest and interest-free demand loans outstanding during 12984 and prior years. See Rev. Proc. 85-46, page 507.

Section 2514.—Powers of Appointment

26 CFR 25.2514-3: Powers of appointment created after October 21, 1942.

Transfer in trust; "Crummey" powers; relinquishment of withdrawal powers. Multiple or successive

"Crummey" withdrawal powers possessed by a sole beneficiary of one trust or possessed by the beneficiary under the provisions of more than one trust are similarly required to be aggregated for purposes of the annual gift tax exemption.

Rev. Rul. 85-88

ISSUE

(1) For purposes of section 2514(e) of the Internal Revenue Code, does a taxable gift result from the successive lapses of two noncumulative powers to withdraw trust corpus held by a beneficiary of a trust in one calendar years?

(2) For purposes of section 2514(e) of the Internal Revenue Code, what is the amount of the taxable gift that results from the lapse of a general power of appointment held by the income beneficiary in each of two identical trusts created by the same grantor under the circumstances described below?

FACTS

Situation 1: In March 1982, *G* created an irrevocable trust under which *S* was granted the right to receive the trust income for S's life and *C* was granted the remainder interest. In addition, *S* was given the right under the trust to withdraw up to $5,000 from each contribution made by any donor to the trust.

The trust instrument required the trustee to provide *S* with notice immediately on receipt of a contribution. *S* had the right for a period of 60 days following receipt of a notice to exercise the right of withdrawal, after which the right lapsed.

G contributed $5,000 to the trust upon its creation. *S* was promptly notified of the contribution, but did not make a demand for withdrawal within the prescribed period. *G* made another $5,000 contribution in September 1982. Again, *S* was notified of the contribution, but the right of withdrawal subsequently lapsed within the year without *S* having exercised it.

Situation 2: In February 1982, *G* created two irrevocable trusts under which *S* was named the life income beneficiary and *C* was designated as the remainderman.

In addition to the life income interest, *S* was given a power in each trust to withdraw $5,000 of the contributions made by any donor in any calendar year. The powers given *S* were exercisable under the same conditions as the powers in Situation 1.

When the trusts were created, *G* contributed $5,000 to each. *S* was promptly notified of the contributions, but did not make a demand for withdrawal with respect to either contribution within the prescribed period. No further contributions were made to either trust in 1982. The two trusts were at all times administered in all respects as separate trusts.

LAW AND ANALYSIS

Section 2514(c) of the Code defines a general power of appointment as a power exercisable in favor of the possessor of the power, the possessor's estate, the possessor's creditors, or the creditors of the possessor's estate. Under section 2514(b) of the Code, the exercise or release of a general power of appointment created after October 21, 1942, is treated for federal gift tax purposes as a transfer of property by the individual possessing such power.

Under section 2514(e) of the Code, the lapse of a general power of appointment created after October 21, 1942, like the release of such a power, results in a transfer for federal gift tax purposes. With respect to any calendar year, however, this rule applies only to the extent the value of the property subject to the lapsed powers exceeds the greater of $5,000 or 5 percent of the aggregate value of the assets ("5 and 5 exemption") out of which the exercise of the lapsed powers could have been satisfied. See section 25.2514-3(c)(4) of the Gift Tax Regulations.

There is no indication in the legislative history of the predecessor of section 2514(e) (section 811(f)(4) of the 1939 Code) that Congress intended that the holder of multiple noncumulative general powers of appointment should receive more than one "5 and 5 exemption" in a calendar year. *See* S.Rep. No. 382, 82 Cong., 1st Sess. 6-7 (1951). Moreover, the language of section 2514(e), states that the exemption applies "with respect to the lapse of *powers* during any calendar year." (Emphasis added.) Thus, under these circumstances, only one 5 and 5 exemption under section 2514(e) is available for all lapses of powers of appointment in a single trust in a calendar year. Accordingly, the beneficiary is entitled to only one $5,000 exemption per calendar year.

The 5 percent test of section 2514(e) is stated in terms of "the aggregate value of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could be satisfied." For example, where a power of appointment is limited to annual trust income, the 5 percent test is based on annual trust income, not the amount of trust corpus. *Fish v. United States*, 291 F. Supp. 59 (D. Ore. 968), *aff'd*, 432 F.2d 1278 (9th Cir. 1970). The 5 percent test is based on the value of the assets subject to the power at the time of the lapse of the power. See section 25.2514-3(c)(4) of the Gift Tax Regulations. Where the donee has more than one noncumulative withdrawal power in the same trust that lapse in a calendar year, the 5 percent test is based on the maximum amount subject to the donee's withdrawal power on the date of lapse of any such power during the calendar year. Where the donee has noncumulative powers to withdraw property from two or more trusts, the 5 percent test is applied by aggregating the amount determined pursuant to the preceding sentence for each such trust with respect to which the withdrawal power has lapsed during the calendar year.

For example, suppose *B* has the power to withdraw $20,000 from the corpus of one trust, and the power lapses on June 1, when the trust corpus is worth $300,000. If *B* has a second noncumulative power to withdraw $20,000 from the corpus of the same trust, and such power lapses on December 1, when the value of the trust corpus has appreciated to $400,000, then the maximum amount of trust assets subject to *B*'s withdrawal power at the time of any lapse during the calendar year would be $400,000, and the amount of *B*'s 5-and-5 exemption for the year would be $20,000 (5% × $400,000). On the other hand, if *B*'s second withdrawal power in the example is exercisable only with respect to a second, separate trust, *B*'s 5-and-5 exemption for the year would be $35,000 (5% × $700,000).

In *Situation 1*, *S*'s powers of withdrawal were limited to contributions to

the trust. Although each contribution creates a new withdrawal power and arguably provides a separate fund for the exercise of each such withdrawal power, only a single 5-and-5 exemption is available to *S* in 1982. Providing a separate 5-and-5 exemption for each contribution would undermine the statutory purposes to limit the exemption provided by section 2514(e). Moreover, section 2514(e) states the $5,000 and 5 percent tests in terms of the aggregate value of the assets out of which the exercise of the lapsed powers could be satisfied. Nothing is said concerning separate tests for each of the funds out of which the lapsed powers could have been exercised.

In *Situation 1*, $10,000 was contributed to the trust in 1982. *S* did not exercise the powers of withdrawal and both powers lapsed within the year. Once a power lapsed, *C* acquired a vested interest in the amount subject to the lapse. Therefore, *C* received a remainder interest in $10,000 in 1982 as a result of the lapsed powers. The gift tax does not apply to the $5,000 portion of the trust property in which *C* has a remainder interest and which is covered by *S*'s 5-and-5 exemption. However, to the extent of *C*'s remainder interest in the excess portion ($10,000 − $5,000 = $5,000) of that property, the gift tax does apply.

Accordingly, under section 2514(e) of the Code, *S* is treated as having made a gift to *C* of the excess $5,000 less the value of *S*'s retained interest in the excess $5,000. The value of the taxable gift from *S* to *C* is computed as the difference between the $5,000 excess and the value of the right in *S* to receive the income for life from the excess $5,000.

In *Situation 2*, the statutory purpose of section 2514(e) of the Code to provide a limited exemption to the general rule that lapses of powers of appointment carry the same transfer tax consequences as releases and exercises would be thwarted if multiple exemptions were allowed. The allowance of multiple 5-and-5 exemptions would be inconsistent with the purpose of the statute. Moreover, as discussed above section 2514(e) applies the 5-and-5 exemption to the aggregate value of the assets out of which the lapsed powers could have been satisfied. Permitting separate 5-and-5 exemptions for multiple trusts would elevate form over substance by providing more favorable treatment where a transfer to a trust is restructured as multiple transfers to separate trusts.

Thus, in *Situation 2*, *S* is allowed one $5,000 exemption for the two powers that lapsed in 1982. As in *Situation 1*, *S* is considered to have made a gift to *C* of *C*'s remainder interest in the $5,000 not covered by the exemption. In order to ensure that *C*'s multiple powers are not treated less favorably than a single power in one trust fund, in *Situation 2* the 5 percent test would be applied by aggregating the maximum amount in each trust subject to *C*'s withdrawal powers with respect to such trust on the date of lapse of such powers during the calendar year.

HOLDINGS

In both *Situations 1* and *2*, *S* is considered to have made a transfer for federal gift tax purposes as a result of the lapse of *S*'s power to withdraw to the extent that the aggregate amount subject to *S*'s powers exceeds the $5,000 exemption provided in section 2514(e) of the Code. In each situation, the amount taxable is $5,000 less the value of *S*'s retained interest in that amount.

Subtitle C.—Employment Taxes
Chapter 22.—Railroad Retirement Tax Act
Subchapter D.—General Provisions

Section 3231.—Definitions

26 CFR 31.3231(a)-1: Who are employers.

Railroad retirement; employer; subsidiary performing service for parent. In situations similar to that in *Railroad Concrete Crosstie Corp. v. Railroad Retirement Board*, 709 F. 2d 1404 (11th Cir. 1983), in which a wholly owned subsidiary manufacturers an item that is integral to the railroad operations of an employer affiliate and provides substantially all of its output to the employer affiliate, the taxes imposed by the Railroad Retirement Tax Act are applicable.

Rev. Rul. 85-177

ISSUE

Are the taxes imposed by the Railroad Retirement Tax Act (chapter 22, subtitle C, Internal Revenue Code) applicable in a situation similar to that in the case of *Railroad Concrete Crosstie Corp. v. Railroad Retirement Board*, 709 F. 2d 1404 (11th Cir. 1983), involving the applicability of the Railroad Retirement Act, 45 U.S.C. chapter 9 (1982) and the Railroad Unemployment Insurance Act, 45 U.S.C. chapter 11 (1982)?

FACTS, LAW AND ANALYSIS

In the decided case, Railroad Concrete Crosstie Corp. (RCC), a wholly owned subsidiary of a railroad, provided 90 percent of the concrete crossties it manufactured to the railroad. The nature of the relationship and the volume of sales between RCC and its parent established the economic dependence of the former upon the latter. Also, the product manufactured and sold by RCC was essential to the functioning of the railroad. Under these facts, RCC's provision of a "steady dependable supply" of its product was held to constitute the performance of a "service" for its parent. RCC was therefore held to be an employer for purposes of the Railroad Retirement Act and the Railroad Unemployment Insurance Act.

Section 3231(a) of the Code defines the term "employer" as any carrier within the meaning of section 3231(g), and any company that is directly or indirectly owned or controlled or under common control with one or more carriers and that operates any equipment or facility or performs any service, except trucking or casual service, in connection with the transportation of passengers or property by railroad, or the receipt, delivery, elevation, transfer in transit, refrigeration or icing, storage, or handling of property transported by railroad.

The definition of "employer" under the Code, the Railroad Retirement Act, and the Railroad Unemployment Insurance Act is, in all significant respects, the same.

HOLDING

In situations similar to that in *Railroad Concrete Crosstie Corp.*, in which a wholly owned subsidiary manufactures an item that is integral to the railroad operations of an employer affiliate and provides substantially all of

its output to the employer affiliate, the taxes imposed by the Railroad Retirement Tax Act are applicable.

Chapter 24.—Collection of Income Tax at Source on Wages
Subchapter A.—Withholding from Wages

Section 3401.—Definitions

26 CFR 31.3401(a)-1: Wages.

Withholding with respect to payments of amounts includible in gross income under section 105(a) of the Code. See Rev. Rul. 85-121, page 57.

Section 3406.—Backup Withholding

26 CFR 35a.9999-3: Questions and answers concerning backup withholding.

Whether the Bureau of Public Debt may be required to deduct and withhold tax from interest on U.S. Treasury obligations paid to citizens of U.S. possessions. See Rev. Rul. 85-200, page 307.

Subtitle D.—Miscellaneous Excise Taxes
Chapter 31.—Retail Excise Taxes
Subchapter B.—Heavy Trucks and Trailers

Section 4051.—Imposition of Tax on Heavy Trucks and Trailers Sold at Retail

26 CFR 145.4051-1: Imposition of tax on heavy trucks and trailers sold at retail.

Exported truck subsequently imported; first retail sale. If a truck is sold by a U.S. manufacturer to a retail dealer for export, and the truck is thereafter exported, used in a foreign country, and imported into the U.S., the first retail sale of the truck after importation is subject to the retailers excise tax imposed by section 4051(a) of the Code.

Rev. Rul. 85-95

ISSUE

Does the retailers excise tax imposed by section 4051(a) of the Internal Revenue Code apply if a truck is sold by a United States manufacturer for export to a foreign country, is exported to, and used in, the foreign country, and is subsequently sold to a United States dealer who imports it into the United States and sells it at retail?

FACTS

X, a United States wholesaler and retailer of used trucks, purchased a used truck in a foreign country for resale in the United States. *X* sold it in the United States to a retail customer on February 4, 1984. The truck in question was originally manufactured in the United States. It was sold by the manufacturer on May 1, 1983 for export to a dealer in the foreign country who resold it at retail in the foreign country. The truck was used in the foreign country before *X* imported it into the United States. The chassis and body of the truck are of the type subject to the retailers excise tax imposed by section 4051(a) of the Code.

LAW AND ANALYSIS

Section 4051(a) of the Code imposes a 12 percent tax on the first retail sale of automobile truck chassis and bodies that are suitable for use with a vehicle which has a gross vehicle weight of more than 33,000 pounds. The sale of a truck is considered to be the sale of a chassis and body.

Section 4052(a)(1) of the Code defines the term "first retail sale" to mean the first sale, for a purpose other than for resale, after manufacture, production, or importation.

Section 4051(a) of the Code, which became effective April 1, 1983, as added by section 512(b)(1) of Pub. L. No. 97-424, 1983-1 C.B. 405, 408. The tax imposed by section 4051(a) replaced the tax formerly imposed under section 4061(a). Section 4061(a) imposed a tax on certain automotive articles sold by the manufacturer, producer, or importer. The section 4061(a) tax was held to apply to the first sale of a taxable article in the United States by the manufacturer, producer, or importer. *Smith v. United States*, 319 F.2d 776, 779 (5th Cir. 1963); *U.S. Truck Sales Co. v. United States*, 229 F.2d 693, 696 (6th Cir. 1956). *See, Indian Motocycle Co. v. United States*, 283 U.S. 570, 574 (1931), X-1 C.B. 439, 440 (1931). Articles imported into the United States that were used prior to importation were nevertheless subject to the section 4061(a) tax if the requirements of section 4061(a) were otherwise met. *Smith v. United States; Circle Discount Corporation v. United States*, 211 F. Supp. 743, 745 (D.D.C. 1962), *aff'd per curiam*, No. 17,633 (D.C. Cir. 1963); Rev. Rul. 58-297, 1958-1 C.B. 401. In this regard, the court in *Smith* stated that such a construction of the statute more fully comported with the legislative purpose to provide a comprehensive and convenient mode of reaching all first or initial sales while avoiding the possibility that the same article would be subject to the excise tax more than once.

The effect of the enactment of section 4051(a) of the Code was to shift the tax from the first sale by the manufacturer, producer, or importer to the first retail sale made by any person. *See*, H.R. Rep. No. 97-945, 97th Cong., 2d Sess. 14 (1982), 1983-1 C.B. 421, 427. The tax imposed by section 4051(a), like the section 4061(a) tax, applies to the first taxable sale of the article in the United States. *See, Smith; U.S. Truck Sales Co.* Likewise, articles imported into the United States that were used prior to importation are subject to the tax imposed by section 4051(a) if the requirements of section 4051(a) are otherwise met. *See, Smith; Circle Discount Corporation.*

In *U.S. Truck Sales Co.*, the court held that the tax imposed by the predecessor to section 4061(a) of the Code did not apply to the resale in the United States of trucks that had been originally sold tax free in the United States and shipped to a foreign country and used there prior to importation. The court reasoned that the tax could not be imposed on the second sale of an article which had already once been subject to the tax, even though that initial sale had been exempted from the tax under another provision of the Code.

However, articles otherwise taxable that are sold tax free by the manufacturer are subject to the manufacturers excise tax on resale in the United States if returned to the United States in an unused and undamaged condition. Section 48.4221-3d(a)(2) of the Manufacturers and Retailers Excise Tax Regulations. *See* Rev. Rul. 81-97, 1981-1 C.B. 498.

In this case, the sale of the used truck by *X* on February 4, 1984, was the first retail sale of the truck in the United States after importation. The retailers tax was not applicable to the original manufacturer's sale of the vehicle for export since the sale was not a sale at retail. No initial retail sale, taxable or tax-free, occurred prior to the exportation of the truck out of the United States. The first retail sale after the ve

hicle was subsequently imported into the United States presented the first, and only, opportunity to impose the tax.

HOLDING

The sale of the truck by *X* after importation into the United States is subject to the retailers excise tax imposed by section 4051(a) of the Code.

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26 CFR 145-4051-1: Imposition of tax on heavy trucks and trailers sold at retail.
(Also Section 7805; 301.7805-1.)

Manufacturers; truck; gross vehicle weight; use of readily attachable components. The gross vehicle weight of a truck must be determined solely on the basis of the strength of the chassis frame and the axle capacity and placement. Readily attachable components may not be taken into account in making the determination.

Rev. Rul. 85-196

ISSUE

Whether readily attachable components may be taken into consideration in determining the gross vehicle weight of a vehicle pursuant to section 145.4051-1(e)(3) of the Temporary Excise Tax Regulations.

FACTS

A truck manufacturer or dealer sells a truck in a retail transaction in which the truck would normally be subject to the tax imposed by section 4051(a)(1) of the Internal Revenue Code if the truck has a gross vehicle weight of more than 33,000 pounds. The gross vehicle weight of the truck, if determined solely on the basis of the strength of the chassis frame and the axle capacity and placement, is more than 33,000 pounds. But the retail purchaser of the truck specifies to the manufacturer or dealer that the truck be equipped with tires (or other readily attachable components) which, if taken into account in determining the gross vehicle weight of the truck, will result in a gross vehicle weight rating for the truck of less than 33,000 pounds.

LAW AND ANALYSIS

Section 4051(a)(1) of the Internal Revenue Code imposes a 12 percent excise tax on the first retail sale of certain enumerated articles, including automobile truck chassis and bodies, truck trailer and semitrailer chassis and bodies, and tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer. Under section 4051(a)(4), a sale of an automobile truck or truck trailer or semitrailer is considered a sale of a chassis and body described in section 4051(a)(1).

Section 4051(a)(2) of the Code provides that the tax imposed by section 4051(a)(1) does not apply to automobile truck chassis and bodies suitable for use with a vehicle which has a gross vehicle weight of 33,000 pounds or less (as determined under regulations prescribed by the Secretary).

Section 4051(a)(3) of the Code provides that the tax imposed by section 4051(a)(1) does not apply to truck trailer and semitrailer chassis and bodies suitable for use with a trailer or semitrailer which has a gross vehicle weight of 26,000 pounds or less (as determined under regulations prescribed by the Secretary).

Section 145.4051-1(e)(3)(i) of the Temporary Excise Tax Regulations provides that, for purposes of section 145.4051 of the temporary regulations, the term "gross vehicle weight" means the maximum total weight of a loaded vehicle. Generally, the maximum total weight is the gross vehicle weight rating of the article as specified by the manufacturer or established by the seller of the completed article, unless the Commissioner finds that that rating is unreasonable in light of the facts and circumstances in a particular case.

Section 145.4051-1(e)(3)(ii) of the temporary regulations provides that a seller must specify or establish a weight rating for each chassis, body, or vehicle sold on or after April 1, 1983, if the article requires no additional manufacture other than (A) the addition of readily attachable articles, such as tire or rim assemblies or minor accessories, (B) the performance of minor finishing operations, such as painting, or (C) in the case of a chassis, the addition of a body. If an article is specially equipped to the purchaser's specifications, those specifications may be used to establish the gross vehicle weight of the article.

Section 145.4051-1(e)(3)(v) of the temporary regulations provides that the seller's gross vehicle weight rating must take into account, among other things, the strength of the chassis frame and the axle capacity and placement. The Commissioner may exclude from the gross vehicle weight rating any readily attachable parts to the extent the Commissioner finds that the use of such parts in computing the gross vehicle weight rating is unreasonable.

In the case of heavy trucks and trailers intended to be subject to the tax imposed by section 4051(a)(1) of the Code, it is not uncommon for the user to specify the size and other characteristics of components such as tires that are readily attachable and that are to be installed on the truck or trailer by the manufacturer or other seller. If the characteristics of these components are used in computing the gross vehicle weight rating of a truck or trailer, the selection of these components could affect whether the truck or trailer is subject to the tax. Indeed, in many situations a user might be able to specify lighter duty components to avoid the tax and then to replace them with heavier duty components that more closely correspond to the strength of the chassis frame and the axle capacity and placement. Thus, use of these components in computing gross vehicle weight purposes of the tax would lead to administration of the tax in an arbitrary and non-uniform manner and would be unreasonable.

HOLDING

The Commissioner has determined that for purposes of computing the gross vehicle weight of a vehicle pursuant to section 145.4051-1(e)(3) of the temporary regulations, the seller may not take into account any readily attachable components of the vehicle. The gross vehicle weight of the truck under the facts above must be determined solely on the basis of the strength of the chassis frame and the axle capacity and placement.

NONRETROACTIVE APPLICATION

Under the authority contained in section 7805(b) of the Code, the conclusion in this revenue ruling will not be applied to sales before April 1, 1986.

Section 4052.—Definitions and Special Rules

26 CFR 145.4052-1: Special rules and definitions.

T.D. 8050

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER D, SUBCHAPTER H, PART 145—TEMPORARY EXCISE TAX REGULATIONS UNDER THE HIGHWAY REVENUE ACT OF 1982 (Pub. L. 97-424); PART 602—REPORTING AND RECORDKEEPING REQUIREMENTS

Excise Tax on Heavy Trucks, Truck Trailers and Semitrailers, and Tractors

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary regulations relating to the excise tax imposed on the retail sale of heavy trucks, truck trailers and semitrailers, and tractors. Changes in the applicable tax law were made by the Highway Revenue Act of 1982 (Title V of the Surface Transportation Assistance Act of 1982) [Pub. L. 97-424, 1983-1 C.B. 405]. These regulations affect manufacturers, producers, importers, dealers, and retailers of these vehicles and will provide them with the guidance needed to comply with the law.

DATES: Generally, these regulations are effective for heavy trucks, truck trailers and semitrailers, and tractors sold on or after April 1, 1983.

FOR FURTHER INFORMATION CONTACT: John Broadbent of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (202-566-3287, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains amendments to the Temporary Excise Tax Regulations (26 CFR Part 145) under section 4052 of the Internal Revenue Code of 1954 (Code) relating to the excise tax on the sale of heavy trucks, truck trailers and semitrailers, and tractors. These amendments conform the regulations to section 512 of the Highway Revenue Act of 1982 (Title V of the Surface Transportation Assistance Act of 1982) (Pub. L. 97-424) [1983-1 C.B. 405]. The temporary regulations provided by this document will remain in effect until superseded by final regulations on this subject.

Temporary regulation §145.4052-1, relating to the excise tax on heavy trucks, truck trailers and semitrailers, and tractors, was published in the Federal Register on April 4, 1983 (T.D. 7882) (48 FR 14361) [1983-1 C.B. 274]. These regulations generally provided that the sale of a heavy vehicle to a purchaser who intends to lease the vehicle long term is not a first retail sale.

SUMMARY OF CHANGES IN TEMPORARY REGULATION

This document amends §145.4052-1(a), (b), and (f) by revising the rules relating to the definition of the first retail sale of a vehicle. Under the new rules, the distinction between long-term and short-term leasing has been eliminated.

If a lease is entered into by the manufacturer, producer, or importer of the vehicle, both the prior rules and the revised rules provide that the first retail sale occurs when the vehicle is leased. Under the revised rules, if a vehicle is sold by the manufacturer, producer, or importer, the sale is treated as the first retail sale unless either (a) the purchaser is not in the business of leasing and intends to resell the vehicle, or (b) the seller and the purchaser register under section 4222, and the purchaser certifies that it intends to resell the vehicle. If a vehicle is sold tax-free but is later leased by the purchaser, the leasing of the vehicle will be deemed to be the first retail sale.

No change has been made to the existing temporary regulations with respect to the event triggering liability for the tax. Under all circumstances, the entire tax is due at the time the first retail sale occurs.

These revised temporary rules apply to sales made on or after April 1, 1983, the effective date of section 4051, with specified transitional rules. In no case, under these transitional rules, will tax be imposed on a vehicle under both the existing temporary regulations and the revised temporary regulations.

In determining the tax base of a vehicle, the retail value of the tires on the vehicle is excluded under section 4052(b)(1)(B)(iii). Under both the existing and the revised regulations, this value is the lowest established price at which the retailer would sell the tires. The existing temporary regulations provide as a safe-harbor rule that if a vehicle retailer has no lowest established price for tires, a price is not unreasonable if it is no more than 50 percent of the tire manufacturer's suggested retail price. This rule permits the tax base to be affected by a price that has no bearing on the actual sales price of the tires and is subject to considerable variation among tire manufacturers. Accordingly, this safe-harbor rule is deleted in these revised temporary regulations, effective prospectively.

NEED FOR TEMPORARY REGULATIONS

There is need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

SPECIAL ANALYSES

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for temporary regulations. Accordingly, the Regulatory Flexibility Act (5 U.S.C. Chapter 6) does not apply, and no regulatory flexibility analysis is required for this rule. This Commissioner of Internal Revenue has determined that this rule is not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis is therefore not required.

PAPERWORK REDUCTION ACT

The collection of information requirements contained in these regulations have been submitted to the Office of Management and Budget for review under the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these regulations is John Broadbent of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Reve-

nue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations

26 CFR Part 145 and part 602 are amended as follows:

PART 145—TEMPORARY EXCISE TAX REGULATIONS UNDER THE HIGHWAY REVENUE ACT OF 1982 (Pub. L. 97-424)

Paragraph 1. The authority citation for part 145 continues to read in part:

Authority: 26 U.S.C. 7805 * * * Section 145.4052-1 also issued under 26 U.S.C. 4052(d).

Par. 2. Section 145.4052-1 is amended as follows:

(a) Paragraph (a) is revised to read as set forth below.

(b) Paragraph (b) is revised to read as set forth below.

(c) The last sentence of paragraph (d)(2)(iii) is revised by adding at the beginning thereof, "For vehicles sold on or after April 1, 1983, and before October 15, 1985,".

(d) paragraph (f) is revised to read as set forth below.

§145.4052-1 Special rules and definitions.

(a) *First retail sale*—(1) *In general.* For purposes of §145.4051-1, the term "first retail sale" means the first sale of an article after manufacture, production or importation. The sale of an article to a purchaser who is not engaged in the business of leasing and who intends to resell the article, is not a first retail sale. In addition, the sale of an article to a purchaser who is engaged in the business of leasing to any extent will not be considered a first retail sale if the purchaser and the seller are registered under §48.4222(a)-1, and the seller in good faith accepts a proper certification, as provided in paragraph (a)(3) of this section, from the purchaser that the purchaser intends to resell the article. The first sale of an article following a tax-free sale of the article shall be considered the first retail sale of the article, unless the subsequent sale qualifies as a tax-free sale under either of the two preceding sentences or under section 4221. An intent to lease an article is not considered an intent to resell the article for purposes of this section. The fact that articles are sold in wholesale lots, or at wholesale prices, will not change the character of such sales as first retail sales if the purchaser is not engaged in the business of reselling such articles and acquires them for the purpose of using them rather than reselling them.

(2) *No installment payments of tax.* If the first retail sale is a lease, an installment sale, or another form of sale under which the sale price is paid in installments, then the liability for the entire tax arises at the time of the lease or installment sale. No portion of the tax is deferred by reason of the fact that the sales price is paid in installments.

(3) *Certificate.* A certificate signed by the purchaser, or an officer or employee authorized by the purchaser to sign the certificate, may be accepted by a seller in support of a tax-free sale to the purchaser. The certificates and proper records of invoices, orders, etc., relating to tax-free sales must be retained by the seller as provided in section 6001 and the regulations thereunder. The certificates shall be substantially in the following form:

EXEMPTION CERTIFICATE

I hereby certify that I am _____
(Title)
of _____
(Name of purchaser)
that I am authorized to execute this certificate, and that the vehicles specified in the accompanying order, or on the reverse side hereof, (or all orders placed by the purchaser of the two year period commencing ___) are purchased for resale and not for the purpose of leasing. I have filed Form 637 and have received registration number ___.

I understand that the fraudulent use of this certificate to secure exemption will subject me and all parties making such fraudulent use to a fine of not more than $10,000, or to imprisonment for not more than 5 years, or both, together with costs of prosecution.

_____
(Signature)

_____
(Address)

(4) *Registration.* Section 4222 and the regulations thereunder shall apply to tax-free sales made under this section.

(b) *Lease treated as first retail sale*—(1) *In general.* For purposes of this section and §145.4051-1, the leasing of an article before the first retail sale (within the meaning of paragraph (a) of this section) of the article shall be considered the first retail sale of the article. This rule applies without regard to the term of the lease. Thus, if a manufacturer leases an article prior to sale, or if a purchaser purchases an article tax free under paragraph (a)(1) of this section or section 4221 and then leases it, the leasing of the article will be deemed to be the first retail sale.

(2) *Computation of tax.* When a lease is treated as the first retail sale under paragraph (b)(1) of this section, the tax shall be computed on a constructive sales price established by the Commissioner as if such article were sold at retail on the date the lease is made.

* * * * *

(f) *Effective date*—(1) *In general.* The provisions of this section shall be effective for articles sold or leased on or after April 1, 1983. However, if a sale to a lessor before November 12, 1985, would have been tax free under §145.4052-1 of the temporary regulations contained in 26 CFR part 145 revised as of April 1, 1984, (the "prior regulations") and it was so treated by the parties, a subsequent sale or lease that was or would have been treated as the first retail sale of the vehicle under the prior regulations will be treated as the first retail sale for purposes of this section. For example, if a vehicle was sold to a purchaer who intended to lease it long term, the sale would have been tax free under the prior regulations. If such a sale was treated as tax free by the parties, and the purchaser later sells the vehicle or leases it long term, the sale or lease will be treated as the first retail sale of the vehicle.

(2) *Vehicle subject to tax only once.* In no case will tax be imposed on the first retail sale of a vehicle under both the prior regulations and this section. If, under the prior regulations, tax was properly paid on the first retail sale of a vehicle, and if the amount of the tax determined under the prior regulations is greater than the amount of tax that would be imposed upon the first retail sale of the vehicle as determined under this section, then the taxpayer shall be entitled to a refund of the difference. For example, if under the prior regulations a lessor treated a long-term lease of a vehicle as a first retail sale, and

paid tax upon making the lease, the taxpayer may claim a refund of any excess of the tax paid under the prior regulations (based on a constructive sales price) over the tax that would be imposed under this section (based on the sales price charged the lessor by the manufacturer or other seller). No additional tax would be payable under this section by a manufacturer that treated the sale of the vehicle to a lessor as a tax-free sale under the prior regulations.

PART 602—REPORTING AND RECORDKEEPING REQUIREMENTS

Par. 3. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. Section 602.101(c) is amended by inserting in the appropriate place in the table:

"§145.4052-1 .... 1545-0745"

There is need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved August 30, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 12, 1985, 8:45 a.m., and published in the issue of the Federal Register for September 13, 1985, 50 F.R. 37350)

Chapter 32.—Manufacturers Excise Taxes
Subchapter A.—Automotive and Related Items
Part I.—Gas Guzzlers

Section 4064.—Gas Guzzler Tax

26 CFR 48.4064-1: Gas guzzler tax. (Also Sections 1016, 4217; 1.1016-5, 48.4217-1.)

T.D. 8036

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; SUBCHAPTER D, PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES; PART 138—TEMPORARY EXCISE TAX REGULATIONS UNDER THE ENERGY TAX ACT OF 1978; SUBCHAPTER H, PART 602—REPORTING AND RECORDKEEPING REQUIREMENTS

Gas Guzzler Tax

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the gas guzzler tax, as provided by section 4064 of the Internal Revenue Code of 1954. Changes to the applicable tax law were made by the Energy Tax Act of 1978 [Pub. L. 95-618, 1978-3 C.B. (Vol. 2) 1]. These final regulations provide manufacturers of automobiles with the guidance needed to comply with that Act.

DATE: This Treasury decision applies to 1980 and later model year automobiles, and is effective July 23, 1985.

FOR FURTHER INFORMATION CONTACT: Robert H. Ginsburgh of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3297).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On February 8, 1980, the FEDERAL REGISTER published proposed amendments to the Excise Tax Regulations (26 CFR Part 48) under sections 4064 and 4222 of the Code, as well as temporary regulations [T.D. 7674, 1980-1 C.B. 241] containing the same rules. A public hearing was held on June 19, 1980. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision. These regulations supersede the temporary regulations issued under §§138.4064-1 and 138.4222-1.

EXPLANATION OF PROVISIONS

The Energy Tax Act of 1978 imposes on the sale by a manufacturer of an automobile a tax determined in accordance with prescribed tables. The tax is applicable to model types of 1980 and later model year automobiles that have a fuel economy level below the applicable tax-free fuel economy level. A small manufacturer may apply to the Secretary for an alternate rate schedule by showing that it is not feasible for that manufacturer to meet the tax-free fuel economy level.

DETERMINATION OF FUEL ECONOMY

The proposed regulations provided for determination of fuel economy in accordance with testing and calculation procedures (weighted 55 percent urban cycle and 45 percent highway cycle) utilized by the Environmental Protection Agency Administrator. One comment requested that the urban fuel economy level be used for purposes of the tax. No change was made, however, since section 4064 clearly states that a weighted urban-highway figure should be used. Another comment noted that no provision dealt with the issue of how the fuel economy estimates calculated by the Environmental Protection Agency should be rounded for purposes of determining which model types are subject to the tax. It was suggested that the figures should be rounded to the nearest one-half mile per gallon increments since the tax is imposed in whole number of miles per gallon increments (*e.g.*, "at least 16 but less than 17" miles per gallon). The regulations were changed to provide that rounding is to be done to the nearest .1 mile per gallon, the rounding rule used by the Environmental Protection Agency. One comment expressed at the public hearing inquired as to the tax status of an automobile that is sold, under certain circumstances, before the time the Environmental Protection Agency has made a determination of fuel economy for the model type. The final regulations provide that the sale of such automobile will be taxable if it is ultimately determined that the fuel economy level of the model type of such automobile is within the taxable range.

The regulations on determining fuel economy value have also been revised to take into account the rule requiring recalculation of fuel economy values

that was promulgated by the Environmental Protection Agency.

ALTERNATE RATE SCHEDULE FOR SMALL MANUFACTURERS

Section 4064(d) allows a small manufacturer to apply to the Secretary for an alternate rate schedule upon a showing that it is not feasible for that manufacturer to meet the tax-free fuel economy level. The proposed regulations required a small manufacturer to establish not only that it was not economically feasible for that manufacturer to meet the tax-free fuel economy level, but also that the granting of an alternate rate schedule would serve a public policy purpose. The proposed regulations prescribed the public policy considerations that would be taken into account by the Secretary in deciding whether to grant an alternate rate schedule to a small manufacturer. One comment objected to the provision in the regulations that would make the availability of the alternate rate schedule dependent upon the public policy considerations. The comment pointed out that the small manufacturer provision provided in section 4064(d) was modeled after a similar provision provided in the Energy Policy and Conservation Act of 1975 ("EPCA"), which prescribes "fleet-wide average standards" and allows small manufacturers to seek an exemption from those standards. It noted that the National Highway Traffic Safety Administration ("NHTSA"), the agency administering EPCA, had interpreted the EPCA small manufacturer provision to allow an exemption from those standards without taking into account public policy considerations of the type prescribed in the proposed regulations under the gas guzzler tax. Although the small manufacturer provision provided in EPCA is similar to the provision provided in section 4064(d), it does not mean that those provisions must be given the same interpretation. EPCA and the Energy Tax Act of 1978 are different statutes that reflect different legislative concerns. In the case of the gas guzzler tax, the Ways and Means Committee Report (H.R. Rep. No. 95-496, Part III, 95th Cong., 1st Sess, 48-49 (1978)) [1978-3 C.B. (Vol. 2) 71, 111] made it clear that Congress was adopting the tax in addition to the existing EPCA system and that:

"The committee believes that it is important for the tax to be highly visible to indicate to consumers that there is a serious energy problem and that the Congress has taken action to deal with it. When the consumer sees the amount of the gas guzzler tax shown on the car invoice, he will realize he is paying a premium (which, in many cases, is substantial) to purchase an inefficient car. Thus, consumers would be provided with a financial and, perhaps, psychological incentive to purchase more fuel-efficient automobiles."

"The committee also feels that if individuals are to be permitted to purchase inefficient cars and detract from the conservation effort made by most others, they should as a matter of equity pay a considerable premium (in the form of a gas guzzler tax) for this privilege."

Although section 4064(d) grants the Secretary discretion to prescribe an alternate rate schedule, that discretion is to be exercised only within the boundaries of the policy guidelines prescribed in the legislative history of the tax. Accordingly, the provisions in the proposed regulations regarding small manufacturers have not been changed in the final regulations.

TAX-FREE SALES OF EMERGENCY VEHICLES

Finally, section 4064(b)(1)(C) provides that emergency vehicles are not included in the definition of automobile and, accordingly, are not subject to the gas guzzler tax. The proposed regulations required registration under section 4222 in order for those vehicles to be sold tax free. One comment suggested adopting a procedure in lieu of registration that would allow a manufacturer under certain circumstances to make tax-free sales of vehicles for resale by the purchaser (dealer) to a second purchaser for emergency use. That suggestion was not adopted because there is no statutory authority for extending tax-free sales of emergency vehicles to resales. Furthermore, such a rule would create administrative and compliance problems. The comment also complained that there was no method prescribed for credit or refund of the gas guzzler tax when a vehicle is sold tax paid and resold for emergency use. The final regulations retain the registration procedure to ensure that only proper sales of emergency vehciles are made. A provision was added, however, to the final regulations to make it clear that a refund or credit of the gas guzzler tax may be obtained if a vehicle is sold tax paid and resold for emergency use under section 4064(b)(1)(C).

SPECIAL ANALYSIS

The Commissioner of Internal Revenue has determined that a Regulatory Impact Analysis is not required because this final rule is not a major rule under Executive Order 12291. Because the notice of proposed rulemaking relating to this final rule was published prior to January 1, 1981, the provisions of the Regulatory Flexibility Act do not apply to this final rule.

PAPERWORK REDUCTION ACT

The collection of information requirements contained in this regulation has been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of this regulation in Robert H. Ginsburgh of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 1, 48, 138, and 602 are amended as follows:

Paragraph 1. The authority citation for Part 138 continues to read as follows:

Authority: 26 U.S.C. 7805 and section 231(b) and (c) of the Energy Tax Act of 1978 (Pub. L. 95-618; 92 Stat. 3174).

Par. 2. Sections 138.4064-1 and 138.4222-1 are removed.

Par. 3. The authority citation for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. Section 602.101(c) is amended by inserting in the appropriate place in the table, "§48.4064-1(d)(5) and (6) ... 1545-0014."

Par. 5. The authority citation for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805. * * *

Par. 6. Section 1.1016-5 is amended by adding a new paragraph (u) at the end thereof to read as follows:

§1.1016-5 Miscellaneous adjustments to basis.

* * * * *

(u) *Gas guzzler tax.* In the case of an automobile upon which the gas guzzler tax was imposed, the basis shall be reduced as provided in section 1016(d).

Par. 7. The authority citation for Part 48 is amended by adding the following citation:

Authority: 26 U.S.C. 7805; * * * §48.4064-1(b)(3) also issued under 26 U.S.C. 4064(b)(1)(C)(iii); §48.4064-1(d)(3)(iii) also issued under 26 U.S.C. 4064(d)(1); §48.4064-1(d)(5) also issued under 26 U.S.C. 4064(d)(2).

Par. 8. The following new section is added immediately after §48.4063-3:

§48.4064-1 Gas guzzler tax.

(a) *General rule*—(1) *In general.* Section 4064 imposes on the sale by the manufacturer of an automobile a tax determined in accordance with the tables in section 4064(a)(1) through (7), and in paragraph (a)(2) of this section. The tax is applicable to model types of 1980 and later model year automobiles that have a fuel economy level below the applicable tax-free fuel economy level. Paragraph (b) of this section defines the following terms: sale, manufacturer, automobile, model year, model type, fuel economy, and fuel. Paragraph (c) of this section contains rules relating to the determination of fuel economy. Paragraph (d) of this section contains a special rule for certain small manufacturers. Paragraph (e) of this section contains rules relating to the tax-free sales of emergency vehicles.

(2) *Tables.* (i) In the case of a 1980 model year automobile:

If the fuel economy of the model type in which the automobile falls is:

	The tax is—
Miles per gallon:	
At least 15	0
At least 14 but less than 15	$200
At least 13 but less than 14	300
Less than 13	550

(ii) In the case of a 1981 model year automobile:

If the fuel economy of the model type in which the automobile falls is:

	The tax is—
Miles per gallon:	
At least 17	0
At least 16 but less than 17	$200
At least 15 but less than 16	350
At least 14 but less than 15	450
At least 13 but less than 14	550
Less than 13	650

(iii) In the case of a 1982 model year automobile:

If the fuel economy of the model type in which the automobile falls is:

	The tax is—
Miles per gallon:	
At least 18.5	0
At least 17.5 but less than 18.5	$ 200
At least 16.5 but less than 17.5	350
At least 15.5 but less than 16.5	450
At least 14.5 but less than 15.5	600
At least 13.5 but less than 14.5	750
At least 12.5 but less than 13.5	950
Less than 12.5	1,200

(iv) In the case of the 1983 model year automobile:

In the fuel economy of the model type in which the automobile falls is:

	The tax is—
Miles per gallon:	
At least 19	0
At least 18 but less than 19	$ 350
At least 17 but less than 18	500
At least 16 but less than 17	650
At least 15 but less than 16	800
At least 14 but less than 15	1,000
At least 13 but less than 14	1,250
Less than 13	1,550

(v) In the case of a 1984 model year automobile:

If the fuel economy of the model type in which the automobile falls is:

	The tax is—
Miles per gallon:	
At least 19.5	0
At least 18.5 but less than 19.5	$ 450
At least 17.5 but less than 18.5	600
At least 16.5 but less than 17.5	750
At least 15.5 but less than 16.5	950
At least 14.5 but less than 15.5	1,150
At least 13.5 but less than 14.5	1,450
At least 12.5 but less than 13.5	1,750
Less than 12.5	2,150

(vi) In the case of a 1985 model year automobile:

If the fuel economy of the model type in which the automobile falls is:

	The tax is—
Miles per gallon:	
At least 21	0
At least 20 but less than 21	$ 500
At least 19 but less than 20	600
At least 18 but less than 19	800
At least 17 but less than 18	1,000
At least 16 but less than 17	1,200
At least 15 but less than 16	1,500
At least 14 but less than 15	1,800
At least 13 but less than 14	2,200
Less than 13	2,650

(vii) In the case of a 1986 or later model year automobile:

In the fuel economy of the model type in which the automobile falls is:

	The tax is—
Miles per gallon:	
At least 22.5	0
At least 21.5 but less than 22.5	$ 500
At least 20.5 but less than 21.5	650
At least 19.5 but less than 20.5	850
At least 18.5 but less than 19.5	1,050
At least 17.5 but less than 18.5	1,300
At least 16.5 but less than 17.5	1,500
At least 15.5 but less than 16.5	1,850
At least 14.5 but less than 15.5	2,250
At least 13.5 but less than 14.5	2,700
At least 12.5 but less than 13.5	3,200
Less than 12.5	3,850

(3) *Liability for tax.* The tax imposed by section 4064 is payable by the manufacturer making the sale. An automobile sold before the time a determination of fuel economy is made for the model type (as defined in paragraph (b)(6) of this section) is subject to tax if it is subsequently determined that the fuel economy level of that model type of automobile is within the taxable range (see paragraph (a)(1) of this section).

(b) *Definitions*—(1) *Sale.* Sale includes the use (within the meaning of section 4218) or the first lease (within the meaning of section 4217(e)) of the automobile by the manufacturer.

(2) *Manufacturer.* The term "manufacturer" has the same meaning assigned to such term under §48.0-2(a)(4). The term "manufacturer" includes a producer or importer. An importer is a person who imports an automobile whether or not in connection with a trade or business.

(3) *Automobile.* The term "automobile" means any four-wheeled vehicle—

(i) Propelled by an engine powered by fuel;

(ii) Manufactured primarily for use on public streets, roads, and highways (except any vehicle operated exclusively on a rail or rails);

(iii) Rated at 6,000 pounds gross vehicle weight or less; and

(iv) Requiring no further manufacturing operations to perform its in-

tended function, other than the addition of readily attachable components, such as mirrors or tire and rim assemblies, or minor finishing operations, such as painting. For this purpose, gross vehicle weight means the value specified by the manufacturer as the maximum design loaded weight of a single vehicle. An automobile does not include a nonpassenger automobile as defined in regulations in effect on November 9, 1978 (49 CFR 523.5 (1978)), which were prescribed by the Secretary of Transportation for section 501 of the Motor Vehicle Information and Cost Savings Act (15 U.S.C. 2001). In addition, an automobile does not include the following: any vehicle sold for use and used primarily as an ambulance or combination ambulance-hearse; any vehicle sold for use and used by the United States or by a State or local government primarily for police or other law enforcement purposes; or any vehicle sold for use and used primarily for firefighting purposes.

(4) *Model year.* The term "model year" means the manufacturer's annual production period (as determined by the Administrator of the Environmental Protection Agency) which includes January 1 of any particular calendar year. If the manufacturer has no annual production year, the model year is the calendar year.

(5) *Model type.* The term "model type" means a particular class of automobile, as determined by regulations in effect on November 9, 1978 (40 CFR 600.002.79(a)(19) (1978)), which were prescribed by the Administrator of the Environmental Protection Agency.

(6) *Fuel economy.* The term "fuel economy" means the average number of miles traveled by an automobile per gallon of fuel consumed, rounded to the nearest .1 mile per gallon. The fuel economy for any model type is determined by the Environmental Protection Agency (as determined in accordance with the procedures provided in paragraph (c) of this section). For this purpose, the fuel economy is a combined (urban-highway weighted average) mileage figure estimated in connection with the determination (or redetermination) of general label value (fuel economy information displayed on a sticker that is affired to new automobiles) mandated under section 506 of the Motor Vehicle Information and Cost Savings Act (15 U.S.C. 2006) and regulations thereunder (40 CFR 600).

(7) *Fuel.* The term "fuel" means gasoline and diesel fuel.

(c) *Determination of fuel economy.* For purposes of this section, the fuel economy for any model type is determined (or redetermined) in accordance with the testing and calculation procedures utilized by the Environmental Protection Agency Administrator for model year 1975 (weighted 55 percent urban cycle and 45 percent highway cycle), or any other procedures (yielding comparable results) established by the Administrator. The Environmental Protection Agency's determination (or redetermination) of a model type's fuel economy is made at the time the general label fuel economy value is calculated (or recalculated). This determination (or redetermination) is conclusive for purposes of this section. A redetermination of a model type's fuel economy value shall be effective only with respect to those automobiles for which the manufacturer is required (or is permitted and chooses) under Environmental Protection Agency regulations to affix labels with the recalculated general label fuel economy value.

(d) *Special rule for small manufacturers*—(1) *In general.* A small manufacturer (as defined in subparagraph (2)(i) of this paragraph) may apply for a determination that it is not feasible for that manufacturer to meet the statutory tax-free fuel economy level for the model year, with respect to all automobiles produced by that manufacturer, or with respect to a particular model type. For this purpose, the Commissioner (or his delegate) will make a determination of maximum feasible fuel economy level with respect to the automobiles that are the subject of the determination, but only after consultation with the Secretary of Energy, the Secretary of Transportation, and the Administrator of the Environmental Protection Agency (or their delegates) to obtain their views. A finding that it is not feasible for the manufacturer to meet the statutory tax-free fuel economy level will be made by the Internal Revenue Service if the maximum feasible fuel economy level (as defined in subparagraph (3)(i) of this paragraph) of the automobiles that are the subject of the determination is lower than the statutory tax-free fuel economy level for those automobiles. If it is determined that it is not feasible for a small manufacturer to meet the statutory tax-free fuel economy level, the Secretary (or his delegate) has the discretion to grant to the manufacturer the alternate rate schedule prescribed in paragraph (d)(3)(iii) of this section in lieu of the applicable statutory tax table prescribed in section 4064(a). The decision whether to grant the alternate rate schedule shall be based on the consideration set forth in paragraph (d)(3)(ii) of this section. If a small manufacturer for which an alternate rate schedule under this paragraph (d) is applicable sells an automobile to an importer, the alternate rate schedule applies to the sale by the importer of such automobile if such automobile is of the model year and type to which such alternate schedule applies.

(2) *Definitions*—(i) *Small manufacturer.* A small manufacturer is any manufacturer who produced (whether or not in the United States) fewer than 10,000 automobiles in the second model year preceding the affected model year (the model year for which the determination under this paragraph is being made), and who can reasonably be expected to produce (whether or not in the United States) fewer than 10,000 automobiles in the affected model year.

(ii) *Manufacturer.* For purposes of this paragraph, the term "manufacturer" does not include a person who is only an importer, but does include a producer of automobiles outside the United States who is also an importer.

(iii) *Members of a controlled group.* For purposes of this paragraph, persons who are members of a controlled group of corporations (as defined in section 1563(a) of the Internal Revenue Code, except that "more than 50 percent" is substituted for "at least 80 percent" each place it appears in section 1563(a)) are treated as one manufacturer.

(3) *Basis for determination*—(i) *Maximum feasible fuel economy level.* For purposes of this paragraph, the maximum feasible fuel economy level is determined by taking into account the same factors used in determining

the maximum feasible fuel economy level under section 502(e) of the Motor Vehicle Information and Cost Savings Act (as amended) and the regulations thereunder in effect on November 9, 1978. (Those regulations for small manufacturers are prescribed in 49 CFR 525 (1978).) In making this determination, the Commission (or his delegate) will consult with the National Highway Traffic Safety Administration of the Department of Transportation.

(ii) *Decision to grant alternate rate schedule.* In deciding whether to grant an alternate rate schedule, the Secretary (or his delegate) will consider whether the use (in the United States) of the automobile serves an important public policy (*e.g.*, providing public transportation or transportation for the handicapped) that overrides the United States' need to conserve energy. The manufacturer has the burden of demonstrating that the public policy consideration involved overrides the United States' need to conserve energy. The Commissioner (or his delegate), after consultation with the Secretary of Energy, the Secretary of Transportation, and the Administrator of the Environmental Protection Agency (or their delegates), will review the information submitted by the manufacturer and report findings and recommendations to the Secretary (or his delegate).

(iii) *Alternate rate schedule and tax.* If an alternate rate schedule is granted, the maximum feasible fuel economy level shall be deemed to be the statutory tax-free fuel economy level. Accordingly, a tax is imposed only on automobiles sold that fail to meet the deemed tax-free fuel economy level. The alternate rate schedule shall be determined by substituting the maximum feasible fuel economy level for the tax-free fuel economy level in the applicable statutory tax table set forth in section 4064(a), and by substituting for the miles per gallon amount prescribed in that applicable table an amount that is the tax-free level decreased by one mile per gallon increments, while keeping the same corresponding tax amount prescribed in that applicable table. The rule for determining an alternate rate schedule may be illustrated by the following example:

Example. Manufacturer X, a small manufacturer of automobiles specifically designed to accommodate disabled passengers, applied for a determination that it is not feasible for X to meet the statutory tax-free fuel economy level for a particular model type of X's 1982 model year automobiles. It was determined that the maximum feasible fuel economy level for that model type was 15 miles per gallon. The Secretary decided to grant X an alternate rate schedule. The alternate rate schedule for the model type would be as follows:

If the fuel economy of the automobile is:	The tax is—
Miles per gallon:	
At least 15	0
At least 14 but less than 15	$ 200
At least 13 but less than 14	350
At least 12 but less than 13	450
At least 11 but less than 12	600
At least 10 but less than 11	750
At least 9 but less than 10	950
Less than 9	1,200

Thus, if X's 1982 automobiles of that model year and type attain only 12 miles per gallon (because X fails to modify them to reach the maximum feasible fuel economy level before they are sold), the tax imposed upon the sale of each automobile is $450 (instead of the $1,200 tax (see the applicable statutory tax table set forth in section 4064(a)(3)), which would have been imposed had no alternate rate schedule been prescribed).

(4) *Duration of determination.* A determination under this paragraph does not apply to more than three model years.

(5) *Requirements for application.* Each application for a determination under this section must—

(i) Identify the model year or years, and particular model type or types for which a determination is requested;

(ii)(A) In the case of an application for model year 1980, be submitted not later than May 8, 1980;

(B) In the case of an application for model year 1981, be submitted not later than 9 months before the beginning of that model year or March 10, 1980, whichever is later;

(C) In the case of an application for model year 1982 or any subsequent model year, be submitted not later than 9 months before that model year;

(iii) Be submitted in three copies to: Commissioner of Internal Revenue, Attention: Associate Chief Counsel (Technical), 1111 Constitution Avenue, N.W., Washington, D.C. 20224;

(iv) Be written in the English language;

(v) Set forth the full name, address, and title of the official responsible for preparing the application;

(vi) State whether the applicant is a member of a controlled group of corporations (as defined in paragraph (d)(2)(iii) of this section);

(vii) State the total number of automobiles manufactured (whether or not in the United States) by the applicant (or the controlled group of corporations in the case where the applicant is a member of the group) in the second model year immediately preceding each affected model year and the total number of automobiles likely to be manufactured in the affected model year;

(viii) Set forth the same information required by an application pursuant to section 502(c) of the Motor Vehicle Information and Cost Savings Act (as amended) and the regulations thereunder (see 49 CFR 525 (1978)) and state whether or not the applicant under this paragraph has also made an application pursuant to such Act; and

(ix) Set forth the reasons why an alternate rate schedule should be granted under paragraph (d)(3)(ii) of this section.

(6) *Update of application.* A manufacturer making an application under this section must update the application when a material change of circumstances occurs on material information not available at the time of applying becomes available. The manufacturer must also furnish any further information that may be required by the Internal Revenue Service.

(7) *Processing of applications.* If a manfacturer's application is found not to contain the information required by this paragraph, the applicant will be informed of the areas of insufficiency. The application will not receive further consideration until the required information is submitted. Each applicant will be informed in writing whether an application has been granted or denied.

(e) *Tax-free sales of emergency vehicles*—(1) *In general.* The tax imposed by section 4064(a) shall not apply to vehicles sold by a manufacturer for use and used (i) primarily as an ambulance or combination ambulance-hearse, (ii) by the United States or by a State or local government primarily for police or other law enforcement purposes, or (iii) primarily for fire-fighting purposes. A vehicle may be sold tax-free by the manufacturer under this paragraph only in those cases where the sale is made directly to a purchaser for an emergency use prescribed in this subparagraph. In order to effect a tax-free sale, the requirements of section 4222 and

the regulations thereunder must be met.

(2) *Credit or refund.* Where tax is paid on the sale of a vehicle, but the vehicle is used or resold for an emergency use prescribed in subparagraph (1) of this paragraph, a claim for refund of the tax paid on such sale may be filed by the manufacturer on Form 843, or a credit may be taken on a subsequent return, in accordance with the provisions of sections 6402(a) and 6416(a) and §48.6416(a)-1.

Par. 9. Section 48.4217-1 is amended by adding a new sentence at the end thereof to read as follows:

§48.4217-1 Lease considered as sale.

* * * However, in the case of the lease of an automobile the sale of which by the manufacturer would be taxable under section 4064, the term includes only the first lease (excluding any renewal or extension of the lease) of such automobile by the manufacturer.

Par. 10. Section 48.4217-2 is amended by adding a new paragraph (i) at the end thereof to read as follows:

§48.4217-2 Limitation on amount of tax applicable to certain leases.

* * * * *

(i) *Cross-reference.* In the case of the lease of an automobile the sale of which by the manufacturer would be taxable under section 4064, the foregoing provisions of this section shall not apply. See section 4217(e) for the rules relating to the payment of the gas guzzler tax.

Par. 11. Section 48.4221-1 is amended by adding a new sentence immediately before the flush material appearing immediately after paragraph (a)(5), to read as follows:

§48.4221-1 Tax-free sales; general rule.

(a) *In general.* * * *

(5) * * *

Subparagraphs (4) and (5) of this paragraph do not apply to the tax imposed by 4064. * * *

* * * * *

Par. 12. Paragraph (a) of the §48.4221-5 is amended by revising the first sentence to read as follows:

§48.4221-5 Tax-free sale of articles to State and local governments for their exclusive use.

(a) *In general.* An article (excluding an automobile subject to tax under section 4064) subject to tax under chapter 32 of the Code may be sold tax free by the manufacturer, pursuant to section 4221(a)(4) of this section, to a State or local government for the exclusive use of such State or local government. * * *

* * * * *

Par. 13. Paragraph (a) of §48.4221-6 is amended by revising the first sentence to read as follows:

§48.4221-6 Tax-free sales of articles to nonprofit educational organizations.

(a) *In general.* An article (excluding an automobile subject to tax under section 4064) subject to tax under chapter 32 of the Code may be sold tax free by the manufacturer, pursuant to section 4221(a)(5) of this section, to a nonprofit educational organization for its exclusive use. * * *

* * * * *

Par. 14. Paragraph (d) of §48.4222(d)-1 is revised to read as follows:

§48.4222(d)-1 Registration in the case of certain other exemptions.

* * * * *

(d) Tax-free sales on or after March 10, 1980, under section 4064(b)(1)(C) (relating to emergency vehicles). Both the vendor and vendee (other than a State or local government) must be registered.

* * * * *

Par. 15. Paragraph (b) of §48.6416(b)-2 is amended by adding a new sentence immediately after the first sentence to read as follows:

§48.6416(b)-2 Tax payments deemed to be overpayments by reason of certain uses, sales, or resales.

* * * * *

(b) *Uses, sales, and resales giving rise to right of refund or credit.* * * * However, subparagraphs (3) and (4) of this paragraph do not apply in the case of any tax paid under section 4064. * * *

* * * * *

(This Treasury decision is issued under the authority contained in sections 4064 and 7805 of the Internal Revenue Code of 1954 (92 Stat. 3175, 26 U.S.C. 4064; 68A Stat. 917, 26 U.S.C. 7805).)

Approved by the Office of Management and Budget under control number.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved June 24, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 22, 1985, 8:45 a.m., and published in the issue of the Federal Register for July 23, 1985, 50 F.R. 29959)

Part II.—Tires

Section 4071.—Imposition of Tax [Manufacturers Excise Tax on Tires]

26 CFR 48.4071-1: Imposition and rates of tax.

T.D. 8057

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER D, PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES

Excise Tax Treatment of Sales of Retreaded Tires

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the definition of manufacture of a new tire. Under the existing regulations, one retreading process, bead-to-bead retreading, constitutes manufacture of a new tire for purposes of the excise tax imposed on tire manufacturers by section 4071 of the Code, while retreading of tires by another process, shoulder-to-shoulder retreading, does not constitute manufacture of a new tire. Under the regulations as hereby amended, neither bead-to-bead nor shoulder-to-shoulder retreading constitutes manufacture of a new tire.

DATES: The regulations are effective for tires sold on or after January 1, 1984.

FOR FURTHER INFORMATION CONTACT: Neal E. Sheldon of the Interpretative Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:I) 202-566-3226, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On February 8, 1984, the FEDERAL REGISTER (49 FR 4790) published proposed amendments to the Excise Tax Regulations (26 CFR part 48) under section 4071 of the Internal Revenue Code of 1954 [I-99-82, 1984-1 C.B. 590]. The amendments were proposed to change the definition of manufacture of a new tire by excluding from such definition retreading of a tire by the bead-to-bead process. One comment was received with respect to the proposed amendment, and no public hearing was requested or held. After consideration of this comment, the proposed amendments are adopted by this Treasury decision without change.

This Treasury decision is issued under the authority contained in section 7805 of the Code (68A Stat. 917; 26 U.S.C. 7805).

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although a notice of proposed rulemaking which solicited public comments was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public procedure requirement of 5 U.S.C. 533 did not apply. Accordingly, the final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of these proposed regulations was Jane E. Wilson of the Interpretative Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and the Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Adoption of Amendments to the regulations.

Accordingly, 26 CFR Part 48 is amended as follows:

Paragraph 1. The authority citation for Part 48 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 2. Section 48.4071-1(d) is revised to read as set forth below:

§48.4071-1 Imposition and rates of tax.

* * * * *

(d) *Recapped or retreaded tires.* The recapping or retreading of a tire, whether from shoulder to shoulder or bead to bead, does not constitute manufacture of a taxable tire. The tax on tires imposed by section 4071 does not apply to the sale of a recapped or retreaded tire, except that a used tire or tire carcass not previously sold int he United States that is recapped or retreaded from shoulder to shoulder or bead to bead in a foreign country and imported into the United States is subject to the tax imposed by section 4071 when such tire is sold or used by the importer. This paragraph (d) is effective for recapped and retreaded tires sold on or after January 1, 1984.

* * * * *

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved September 24, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on October 10, 1985, 8:45 a.m., and published in the issue of the Federal Register for October 11, 1985, 50 F.R. 41490)

Subchapter D.—Recreational Equipment
Part I.—Sporting Goods

Section 4161.—Imposition of Tax

26 CFR 48.4161(a)-1: Imposition and rate of tax; fishing equipment.
(Also Sections 4181, 4182, 6011, 6071, 6081, 6091, 6109, 6161, 6206, 6302, 6412, 6416, 6420, 6421, 6424, 6427, 6675; 48.4181-2, 48.4182-1, 48.6011(a)-1, 48.6071(a)-1, 48.6081(a)-1, 48.6091-1, 48.6109-1, 48.6161(a)-1, 48.6206-1, 48.6302(c)-1, 48.6412-1, 48.6416(a)-1, 48.6420-1, 48.6421-1, 48.6424-1, 48.6427-1, 48.6675-1.)

T.D. 8043

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, SUBCHAPTER H, PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES; PART 154—TEMPORARY REGULATIONS IN CONNECTION WITH THE AIRPORT AND AIRWAY REVENUE ACT OF 1970; PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Manufacturers Excise Taxes on Sporting Goods and Firearms and Other Administrative Provisions of Special Application to Manufacturers and Retailers Excise Taxes.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations which revise and update the regulations on manufacturers excise taxes on sporting goods and firearms and other administrative provisions especially applicable to manufacturers and retailers excise taxes. These amendments revise and update Part 48 to achieve greater clarity and conform the regulations to numerous amendments to the Internal Revenue Code of 1954 made after 1964. These regulations provide necessary guidance to the public for compliance with the law.

DATES: Except as otherwise provided the amendments made by this document are effective after December 31, 1954.

FOR FURTHER INFORMATIO

CONTACT: Ada S. Rousso of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W. Washington, D.C. 20224 (Attention: CC:LR:T: 202-566-4336, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On January 5, 1983, the FEDERAL REGISTER published proposed amendments to the Manufacturers and Retailers Excise Tax Regulations (26 CFR Part 48) under sections 4161, 4181, 4182, 6011, 6071, 6081, 6091, 6101, 6109, 6151, 6161, 6206, 6302, 6412, 6416, 6420, 6421, 6424, 6427 and 6675 [LR-2115, 1983-1 C.B. 846]. Subsequent to the publication of the proposed amendments, certain changes to the applicable law were made by the Highway Revenue Act of 1982 (96 Stat. 2181) [Pub. L. 97-424, 1983-1 C.B. 405] and the Tax Reform Act of 1984 (98 Stat. 494) [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. These final regulations have been revised to reflect those changes to the law. A public hearing was neither held nor requested. One comment was received which suggested that the proposed regulation provided that the customer who either reloads his own cartridges or has another person reload the cartridges for him would be liable for the excise tax on the reloaded cartridges. However, that was not the proper interpretation. The proposed regulation merely provided that the customer who has cartridges reloaded would be liable for excise tax only in the event that the customer thereafter sold the reloaded cartridge. The use by the customer is not subject to the tax because of the personal use exemption under section 4218.

The existing regulation provides that a price readjustment to the purchaser is made when the price of an article on which tax has been paid is later readjusted because the article or its covering or container is returned or repossessed, or a bona fide discount, rebate or allowance against the sales price is made. That part of the tax which is proportionate to the part of the price which is repaid or credited to the purchaser is considered to be an overpayment. Comments from within the Service indicated that the proposed regulation on the determination of a price readjustment was unclear after an example relating to a bona fide discount, rebate or allowance was deleted in the proposed regulation.

Since no change was intended with regard to a determination of price readjustment, *example (1)* of §48.6416(b)(1)-2(e)(1) is reinserted in the final regulation.

STATUTORY AMENDMENTS REFLECTED IN THE FINAL REGULATIONS

Many statutory changes enacted after 1964 have not previously been reflected in Part 48 of the regulations. The table set forth below enumerates the statutory changes reflected in these final regulations. The section numbers on the left margin list the sections of the Code to which the statutory changes relate.

4161:	1.	Section 201 of the Act of October 25, 1972, Pub. L. 92-558, 86 Stat. 1173 [1972-2 C.B. 701, 702], relating to the imposition of tax on bows and arrows. The amendments to the regulations made under section 201 shall apply with respect to articles sold by the manufacturer, producer, or importer on or after July 1, 1974.
6206:	1.	Section 207(d)(3) of the Airport and Airway Development Act of 1970, Pub. L. 91-258, 84 Stat. 219 [1970-1 C.B. 361, 367], relating to rules applicable to excessive claims. The amendments to the regulations made under section 207(d)(3) shall apply with respect to sales made on or after July 1, 1970.
	2.	Section 202(c)(2)(A) of the Excise Tax Reduction Act of 1965, Pub. L. 89-44, 79 Stat. 136 [1965-2 C.B. 568, 570], relating to special rules applicable to excessive claims. The amendments to the regulations made under section 202(c)(2)(A) shall apply only with respect to lubricating oil placed in use after December 31, 1965.
6412:	1.	Section 502(c) of the Federal Aid Highway Act of 1978, Pub. L. 95-599, 92 Stat. 2689 [1978-2 C.B. 403, 404], relating to floor stock refunds.
	2.	Section 303(b) of the Federal Aid Highway Act of 1976, Pub. L. 94-280 90 Stat 425 [1976-2 C.B. 518], relating to floor stock refunds.
6416:	1.	Sections 205(b)(3) and (4) and 207(d)(4) through (d)(7) of the Airport and Airway Revenue Act of 1970, Pub. L. 91-258, 84 Stat. 219 [1970-1 C.B. 361, 364, 367], allowing refund or credit of gasoline taxes when gasoline is used in the production of special fuels. The regulations under sections 205(b)(3) and (4) and 207(d)(4) through (d)(7) are effective after June 30, 1970.
	2.	Section 302 of the Excise, Estate and Gift Tax Adjustment Act of 1970, Pub. L. 91-614, 84 Stat. 1836 [1971-1 C.B. 533, 538], modifying the refund and credit provisions for the use of next tax-paid component parts in further manufacture. The regulations under section 302 are effective for claims filed after December

31, 1979, but only if the filing of the claim is not barred on January 1, 1971, any law or rule of law.

3. Sections 401(a)(3)(C) and 401(g)(6) of the Revenue Act of 1971, Pub. L. 92-1 85 Stat. 497 [1972-1 C.B. 443, 464] allowing a refund or credit for certain tr containers. The regulations under section 401(a)(3)(c) and 401(g)(6) are effect with respect to articles sold after December 10, 1971.

4. Sections 1904(b)(1) and (2), 1906(a)(24), 1906(b)(13)(A) and 2108 of the T Reform Act of 1976, Pub. L. 94-455, 90 Stat. 1520 [1976-3 C.B. (Vol. 1) 291, 303, 310, 380], eliminating numerous deadwood provisions and allowing fund or credit for certain truck parts and accessories. The regulations under s tions 1904(b)(1) and (2), 1906(a)(24)(A) and 1906(b)(13)(A) are effective af January 31, 1977. The regulations under section 1906(a)(24)(B)(i) are effecti with respect to uses or resales for use of liquids after December 1, 1976. The r ulations under 2108 are effective with respect to parts and accessories sold af October 4, 1976.

5. Section 2(b)(4) of the Black Lung Benefits Revenue Act of 1977, Pub. L. 95-22 92 Stat. 11 [1978-1 C.B. 494, 495], modifying the refund and credit provisio for the excise tax on coal. The regulations under section 2(b)(4) are effective w respect to sales after March 31, 1978.

6420: 1. Section 809(a) the Excise Tax Reduction Act of 1965, Pub. L. 89-44, 79 St 136 [1965-2 C.B. 568, 596], relating to income tax credit in lieu of payment w respect to gasoline used on farms. The regulations under section 809(a) are eff tive with respect to gasoline used on or after July 1, 1965.

2. Section 207(b) of the Airport and Airway Development Act of 1970, Pub. 91-258, 84 Stat. 219 [1970-1 C.B. 361, 367], relating to the time for filing clai under section 6420. The regulations under section 207(b) are effective with spect to taxable years ending after June 30, 1970.

3. Section 3(a) of the Act of October 14, 1978, Pub. L. 95-458, 92 Stat. 12 [1978-2 C.B. 367, 368], relating to entitlement of aerial applicators to refund gasoline tax in certain cases. The regulations under section 3(a) are effective gasoline used after March 31, 1979.

6421: 1. Section 809(b) of the Excise Tax Reduction Act of 1965, Pub. L. 89-44, 79 St 136 [1965-2 C.B. 568,596], relating to income tax credit in lieu of payment w respect to gasoline used for certain nonhighway purposes or by local transit s tems. The regulations under section 809(b) are effective with respect to gasol used after June 30, 1965.

2. Section 205(b)(1) of the Airport and Airway Development Act of 1970, Pub. 91-258, 84 Stat. 219 [1970-1 C.B. 361,363], relating to credit or refund of ga line used as a fuel in an aircraft (other than aircraft in noncommercial aviatio The regulations under section 205(b)(1) are effective after June 30, 1970.

3. Section 207(b) of the Airport and Airway Development Act of 1970, Pub. 91-258, 84 Stat. 219 [1970-1 C.B. 361, 367], relating to the time for filing cla under section 6421. The regulations under section 207(b) are effective for taxa years ending after June 30, 1970.

4. Section 222(a)(1) of the Energy Tax Act of 1978, Pub. L. 95-618, 92 Stat. 3 [1978-3 C.B. (Vol. 2) 1, 12], relating to refund or credit of tax on gasoline u in a qualified business use. The regulations under section 222(a)(1) are effec with respect to uses after December 31, 1978.

5. Section 233(a)(1) of the Energy Tax Act of 1978, Pub. L. 95-618, 92 Stat. 3 [1978-3 C.B. (Vol. 2) 1, 16], relating to repayment of tax on gasoline use intercity, local or school buses. The regulations under section 233(a)(1) are ef tive with respect to uses after November 30, 1978.

6. Section 108(c)(1) of the Technical Corrections Act of 1979, Pub. L. 96-222 Stat. 194 [1980-1 C.B. 499,516], relating to repayment of tax on gasoline use vessels employed in the fisheries or the whaling business. The regulations u section 108(c)(1) are effective with respect to uses after December 31, 1978

6424:

1. Section 202(b) of the Excise Tax Reduction Act of 1965, Pub. L. 89-44, 79 Stat. 136 [1965-2 C.B. 568, 570], relating to refund or credit of tax on lubricating oil not used in highway motor vehicles. The regulations under section 202(b) are effective with respect to lubricating oil placed in use after December 31, 1965.

2. Section 207(b) of the Airport and Airway Development Act of 1970, Pub. L. 91-258, 84 Stat. 219 [1970-1 C.B. 361, 367], relating to the time for filing claims under section 6424. The regulations under section 207(b) are effective for taxable years ending after June 30, 1970.

3. Section 233(b)(1) of the Energy Tax Act of 1978, Pub. L. 95-618, 92 Stat. 3174 [1978-3 C.B. (Vol. 2) 1, 17], relating to credit or refund of tax on lubricating oil used in a qualified business use or in a qualified bus.

6427:

1. Section 207(a) of the Airport and Airway Development Act of 1970, Pub. L. 91-258, 84 Stat. 219 [1970-1 C.B. 361, 366], relating to credit or refund of tax on gasoline and special fuels used for certain purposes. The regulations under section 207(a) are effective with respect to taxable years ending after June 30, 1970.

2. Section 3(b), of the Act of October 14, 1978, Pub. L. 95-458, 92 Stat. 1257 [1978-2 C.B. 367, 368], relating to entitlement of aerial applicators to refunds of special fuels tax in certain cases. The regulations under section 3(b) are effective for gasoline used after March 31, 1979.

6675:

1. Section 202(c)(3)(A) of the Excise Tax Reduction Act of 1965, Pub. L. 89-44, 79 Stat. 136 [1965-2 C.B. 568, 571], relating to civil penalty for excessive claims under section 6424 with respect to lubricating oil. The regulations under section 202(c)(3)(A) are effective with respect to oil used after December 31, 1965.

2. Section 207(d)(8) of the Airport and Airway Development Act of 1970, Pub. L. 91-258, 84 Stat. 219 [1970-1 C.B. 361, 367], relating to civil penalty for excessive claims under section 6427 with respect to fuels not used for taxable purposes. The regulations under section 207(d)(8) are effective after June 30, 1970.

STATUTORY AMENDMENTS NOT REFLECTED IN THE FINAL REGULATIONS

The table set forth below enumerates the post-1964 statutory changes relating to manufacturers and retailers excise taxes which are not reflected in these final regulations.

4161

1. Sections 1015 and 1017 of the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-1 C.B. (Vol. 1) 1, 525, 529] relating to taxes on the sale of sport fishing equipment and certain arrows. These amendments are expected to be the subject of another regulation project.

4162:

1. Section 1015(b) of the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol.1) 1, 525] relating to definitions of sport fishing equipment and the treatment of certain resales. This amendment will be the subject of another regulation project.

6302:

1. Section 1015(c) of the Tax Reform Act of 1984 [Pub. L.98-369, 1984-3 C.B. (Vol. 1) 1, 526] relating to the time for payment of manufacturers excise tax on sport fishing equipment. This amendment will be the subject of another regulation project.

6416:

1. Sections 201(c)(3), 232(b) and 233(c)(3) of the Energy Tax Act of 1978 [1978-3 C.B. (Vol. 2), 1, 10, 15, 18] relating to the refund and credit provisions for tread rubber, tires, inner tubes, and certain parts and accessories of automobile buses and light-duty trucks. These amendments are the subject of another regulation project.

2. Section 108(c)(2)(A-(2)(B) and (c)(3)-(c)(4) of the Technical Corrections Act of 1979 [Pub. L. 96-222, 1980-1 C.B. 499, 517] relating to the refund and credit provisions for lubricating oil, tires, and inner tubes. This amendment is the subject of another regulation project.

3. Sections 1(a)-(b)(2)(D) and 4(c) of the Act of December 24, 1980, P.L. 96-598, 94 Stat. 3485 [1980-2 C.B. 661], relating to the refund and credit provisions for tax paid on tread rubber used in recapping or retreading a tire. These amendments are the subject of another regulation project.

6427:

1. Section (1)(b) of the Act of October 17, 1976, P.L. 94-530, 90 Stat. 2487 [1976-2 C.B. 555], relating to credit or refund of tax on gasoline and special fuels used by certain aircraft museums. This Act expired on October 1, 1982. The tax was reinstituted by the Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462]. This amendment is the subject of another regulation project.

2. Section 505(a) of the Highway Revenue Act of 1978 [Pub. L. 95-599, 1978-2 C.B. 403, 404], relating to credit or refund for certain taxicabs of excise taxes on gasoline and other motor fuels. [The provisions of section 505(a) are not expected to be the subject of another regulation project.]

3. Section 232(d)(1) of the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 1, 49], relating to refund of tax on gasoline used to produce certain alcohol fuels. This statutory change is expected to be the subject of another regulation project.

PAPERWORK REDUCTION ACT

The collection of information requirements contained in these regulations have been submitted to the Office of Management and Budget for review in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although a notice of proposed rulemaking which solicited public comments was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public procedure requirement of 5 U.S.C. 553 did not apply. Accordingly, the final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of this regulation is Ada S. Rousso of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 48, 154, and 602 are amended as follows:

Paragraph 1. The authority citation for Part 48 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 2. Section 48.0-1 is revised to read as follows. Sections 48.0-3 and 48.0-4 are removed. Section 48.0-5 is redesignated as §48.0-3.

§48.0-1 Introduction.

The regulations in this part (Part 48, Subchapter D, Chapter I, Title 26, Code of Federal Regulations) are designated "Manufacturers and Retailers Excise Tax Regulations. "The regulations relate to the taxes imposed by sections 4041, 4042 and 4051 or by chapter 32 of the Internal Revenue Code of 1954, as amended, and to certain related administrative provisions of subtitle F of the Code. Section 4041 imposes taxes on certain sales or uses of the special fuels described in that section, and on certain sales or uses of gasoline as a fuel in aircraft engaged in noncommercial aviation. Section 4042 imposes taxes on liquids used as fuel in certain vessels in commercial waterway transportation. Section 4051 imposes taxes on heavy trucks, trailers and certain tractors sold at retail. Chapter 32 of the Code imposes taxes on the sale or use by the manufacturer, producer, or importer of articles specified in that chapter. References in the regulations in this part to the "Internal Revenue Code" or the "Code" are references to the Internal Revenue Code of 1954, as amended, unless otherwise indicated. References to a section or other provision of law are references to a section or other provision of the Internal Revenue Code, as amended, unless otherwise indicated.

Par. 3. Section 48.4161(a)-1 is amended by revising paragraph (c) to read as follows.

§48.4161(a)-1 Imposition and rate of tax; fishing equipment.

* * * * *

(c) *Liability for tax.* The tax imposed by section 4161(a) is payable by the manufacturer, producer, or importer making the sale. For determining who is the manufacturer, producer, or importer, see §48.0-2(a)(4).

Par. 4. Section 48.4161(a)-2 is amended by revising paragraph (d) to read as follows.

§48.4161(a)-2 Meaning of terms.

* * * * *

(d) *Artificial lures, baits, and flies.* The term "artificial lures, baits, and flies" includes all artifacts, of whatever materials made, that simulate an article considered edible by fish and are designed to be attached to a line or hook to attract fish so that they may be captured. Thus, the term includes such artifacts as imitation flies, blades, spoons, and spinners, and edible materials that have been processed so as to resemble a different edible article considered more attractive to fish, such as bread crumbs treated so as to simulate salmon eggs, and pork rind cut and dyed to resemble frogs, eels, or tadpoles.

Par. 5. Section 48.4161(a)-3 is amended by revising paragraph (b) to read as follows.

§48.4161(a)-3 Parts and accessories.

* * * * *

(b) *Essential equipment.* If taxable articles are sold by the manufacturer, producer, or importer thereof, without parts or accessories that are essential for their operation, or are designed directly to improve the performance or appearance of the articles, the separate sale of the parts or accessories to the same vendee will be considered, in the absence of evidence to the contrary, to have been made in connection with the sale of the basic article, even though the parts or accessories are shipped separately at the same time or on a different date.

Par. 6. Section 48.4161(b)-1 is amended by revising paragraph (c) to read as follows:

§48.4161(b)-1 Imposition and rates of tax; bows and arrows.

* * * * *

(c) *Liability for tax.* The tax imposed by section 4161(b) is payable by the manufacturer, producer, or importer making the sale. For determining who is the manufacturer, producer, or importer, see §48.0-2(a)(4).

Par. 7. Section 48.4181-2 is amended by revising paragraph (d) to read as follows.

§48.4181-2 Meaning of terms.

* * * * *

(d) *Shells and cartridges.* (1) The terms "shells" and cartridges" include any article consisting of a projectile, explosive, and container that is designed, assembled, and ready for use without further manufacture in firearms, pistols or revolvers.

(2) A person who reloads used shells or cartridges is a manufacturer of shells or cartridges within the meaning of section 4181 if such reloaded shells or cartridges are sold by the reloader. However, the reloader is not a manufacturer of shells or cartridges if, in return for a fee and expenses, the reloads shells or cartridges submitted by a customer and returns the identical shells or cartridges to that customer. Under such circumstances, the customer would be the manufacturer of the shells or cartridges and may be liable for tax on the sale of the articles. See section 4218 and §48.4218-2.

Par. 8. Section 48.4182-1 is amended by revising paragraph (b) to read as follows.

§48.4182-1 Exempt sales.

* * * * *

(b) *Sales to Defense Department or to U.S. Coast Guard*—(a) *Military department.* Section 4182(b) provides that the tax imposed by section 4181 shall not attach to the sale of firearms, pistols, revolvers, shells, or cartridges that are purchased with funds appropriated for a military department of the United States. For this purpose, the term "military department" means the Department of the Army, the Department of the Navy, and the Department of the Air Force. Included in the Department of the Navy are naval aviation and the Marine Corps and, when operating as a service in the Navy pursuant to the provisions of 14 U.S.C. 34, the Coast Guard.

(2) *Coast Guard.* (i) 14 U.S.C. 655, as added by sec. 5 of the Act of July 10, 1962. (Pub. L. 87-526, 76 Stat.142), provides as follows:

Sec. 655. *Arms and ammunition: immunity from taxation.* No tax on the sale or transfer of firearms, pistols, revolvers, shells, or cartridges may be imposed on such articles when bought with funds appropriated for the United States Coast Guard.

(ii) In view of the provisions of 14 U.S.C. 655, the tax imposed by section 4181 shall not attach to the sale of firearms, pistols, revolvers, shells, or cartridges that are purchased with funds appropriated for the U.S. Coast Guard whether or not the Coast Guard is operating as a service in the Navy pursuant to 14 U.S.C. 3.

(3) *Supporting evidence.* (i) Any manufacturer, producer, or importer claiming an exemption from the tax imposed by section 4181 by reason of section 4182(b) must maintain such records and be prepared to produce such evidence as will establish the right to the exemption. Generally, clearly identified orders or contracts of a military department or the Coast Guard signed by an authorized officer of the military department or the Coast Guard will be sufficient to establish the right to the exemption. In the absence of such orders or contracts, a statement, signed by an authorized officer of a military department or the Coast Guard, that the prescribed articles were purchased with funds appropriated for that military department or the Coast Guard will constitute satisfactory evidence of the right to the exemption.

(ii)(A) *In general.* Under 18 U.S.C. 922(b)(5), a manufacturer, dealer, or importer licensed under 18 U.S.C. 923 is required to record the name, age, and place of residence of an individual person, or the identity and principal and local places of business of a corporation or other business entity, to whom the licensee sells or delivers any firearm or ammunition. 18 U.S.C. 923(g) requires the licensee to maintain such records and to make them available for inspection.

(B) *Exception.* However, under section 4182(c) of the Internal Revenue Code, no person holding a license under 18 U.S.C. 933 shall be required to record the name, address, or other information about the purchaser of shotgun ammunition, ammunition suitable for use only in rifles generally available in commerce, or component parts for such ammunition.

Par. 9. Sections 48.6011(a)-1 and 48.6011(a)-2 are revised to read as follows.

§48.6011(a)-1 Returns.

(a) *In general.* (1) Liability for tax imposed under section 4041, 4042 or 4051 or chapter 32 of the Code shall be reported on Form 720. Except as provided in paragraph (b) of this section, a return on Form 720 shall be filed for a period of one calendar quarter.

(2) Every person required to make a return on Form 720 for the return period ended June 30, 1965, shall make a return for each subsequent calendar quarter, month, or semimonthly period (whether or not liability was incurred for any tax reportable on the return for the return period) until the person has filed a final return in accordance with §48.6011(a)-2.

(3) Every person not required to make a return on Form 720 for the return period ended June 30, 1965, shall make a return for the first calendar quarter thereafter in which he incurs liability for tax imposed under section

4041, 4042 or 4051 or chapter 32, and shall make a return for each subsequent calendar quarter, month, or semimonthly period until the person has filed a final return in accordance with §48.6011(a)-2.

(4) Each return required under the regulations in this part, together with any prescribed copies, records, or supporting data, shall be completed in accordance with the applicable forms, instructions, and regulations.

(b) *Monthly and semimonthly returns*—(1) *Requirement.* If the district director determines that any taxpayer who is required to deposit taxes under the provisions of §48.6302(c)-1 has failed to make deposits of those taxes, the taxpayer shall be required, if so notified in writing by the district director, to file a monthly or semimonthly return on Form 720. Every person so notified by the district director shall file a return for the calendar month or semimonthly period (as defined in §48.6302(c)-1(b)) in which the notice is received and for each calendar month or semimonthly period thereafter until the person has filed a final return in accordance with §48.6011(a)-2 or is required to file returns on the basis of a different return period pursuant to notification as provided in paragraph (b)(2) of this section.

(2) *Change of requirement.* The district director may require the taxpayer, by notice in writing, to file a quarterly or monthly return, if the taxpayer has been filing returns for a semimonthly period, or may require the taxpayer to file a quarterly or semimonthly return, if the taxpayer has been filing monthly returns.

(3) *Return for period change takes effect.* (i) If a taxpayer who has been filing quarterly returns receives notice to file a monthly or semimonthly return, or a taxpayer who has been filing monthly returns receives notice to file a semimonthly return, the first return required pursuant to the notice shall be filed for the month or semimonthly period in which the notice is received and all months or semimonthly periods which are not includible in an earlier period for which the taxpayer is required to file a return.

(ii) If a taxpayer who has been filing monthly or semimonthly returns receives notice to file a quarterly return, the last month or semimonthly period for which a return shall be filed is the last month or semimonthly period of the calendar quarter in which the notice is received.

(iii) If a taxpayer who has been filing semimonthly returns receives notice to file a monthly return, the last semimonthly period for which a return shall be made is the last semimonthly period of the month in which the notice is received.

§48.6011(a)-2 Final returns.

(a) *In general.* Any person who is required to make a return on Form 720 pursuant to §48.601(a)-1, and who in any return period ceases operations in respect of which the person is required to make a return on the form, shall make the return for that period as a final return. Each return made as a final return shall be marked "Final Return" by the person filing the return. A person who has only temporarily ceased to incur liability for tax required to be reported on Form 720 because of temporary or seasonal suspension of business or for other reasons, shall not make a final return but shall continue to file returns.

(b) *Statement to accompany final return.* Each final return shall have attached a statement showing the address at which the records required by the regulations in this part will be kept, the name of the person keeping the records, and, if the business of the taxpayer has been sold or otherwise transferred to another person, the name and address of that person and the date on which the sale or transfer took place. If no sale or transfer occurred or if the taxpayer does not know the name of the person to whom the business was sold or transferred, that fact should be included in the statement.

(c) An individual's signature on a return, statement, or other document made by or for a corporation or a partnership shall be prima facie evidence that the individual is authorized to sign the return, statement, or other document.

Par. 10. Section 48.6071(a)-1 is revised to read as follows:

§48.6071(a)-1 Time for filing returns.

(a) *Quarterly returns.* Each return required to be made under §48.6011(a)-1(a) for a return period of not les than one calendar quarter shall be file on or before the last day of the first cal endar month following the close of th period for which it is made. Howeve a return may be filed on or before th 10th day of the second calendar mont following the close of the period i timely deposits under section 6302(c of the Code and the regulations there under have been made in full paymer of the taxes due for the period. For th purposes of the preceding sentence, deposit which is not required by regula tions in respect of the return perio may be made on or before the last da of the first calendar month followin the close of the period, and the timel ness of any deposit made otherwis than by mail will be determined by th earliest date stamped on the Federa Tax Deposit form by an authorized f nancial institution or by a Federal Re serve bank. For determining the timel ness of a deposit made by mail, se section 7502(e) and §301.7502-1 c this chapter (Regulations on Procedu and Administration).

(b) *Monthly and semimonthl returns*—(1) *Monthly returns.* Each re turn required to be made unde §48.6011(a)-1(b) for a monthly perio shall be filed not later than the 15th da of the month following the close of th period for which it is made.

(2) *Semimonthly returns.* Each retu required to be made under §48.601 (a)-1(b) for a semimonthly period sha be filed not later than the 10th day the semimonthly period following th close of the period for which it made.

(c) *Last day for filing.* For provisio relating to the time for filing a retu when the prescribed due date falls on Saturday, Sunday, or legal holiday, s §301.7503-1 of this chapter (Regul tions on Procedure and Administr tion).

(d) *Late filing.* For additions to t tax in case of failure to file a retu within the prescribed time, s §301.6651-1 of this chapter (Regul tions on Procedure and Administr tion).

Par. 11. The following ne §48.6081(a)-1 is added immediately a ter §48.6071(a)-1.

§486081(a)-1 Extension of time for fi ing returns.

(a) *In general.* Ordinarily, no extension of time will be granted for filing any return statement or other document required with respect to the taxes imposed by section 4041, 4042 or 4051 or chapter 32, because the information required for the filing of those documents is under normal circumstances readily available. However, if because of temporary conditions beyond the taxpayer's control, a taxpayer believes an extension of time for filing is justified, the taxpayer may apply to the district director, or to the director of the service center for an extension. An extension of time for filing a return does not operate to extend the time for payment of the tax or any part of the tax unless so specified in the extension. For extensions of time for payment of the tax, see §48.6161(a)-1.

(b) *Application for extension of time.* The application for an extension of time for filing the return shall be addressed to the district director, or director of the service center, with whom the return is to be filed and must contain a full recital of the causes for the delay. It should be made on or before the due date of the return, and failure to do so may indicate negligence and constitute sufficient cause for denial. It should, where possible, be made sufficiently early to permit consideration of the matter and reply before what otherwise would be the due date of the return.

(c) *Filing the return.* If an extension of time for filing the return is granted, a return shall be filed before the expiration of the period of extension.

Par. 12. Section48.6091-1 is revised to read as follows.

§48.6091-1 Place for filing returns.

(a) *Persons other corporations.* The return of a person other than a corporations shall be filed with the district director for the internal revenue district in which is located the principal place of business or legal residence of the person. If the person has no principal place of business or legal residence in any internal revenue district, the return shall be filed with the District Director, Internal Revenue Service, Baltimore, MD 21202, except as provided in paragraph (c) of this section.

(b) *Corporations.* The return of a corporation shall be filed with the district director for the district in which is located the principal place of business or principal office or agency of the corporation, except as provided in paragraph (c) of this section.

(c) *Returns of taxpayers outside the United States.* The return of a person (including a United States citizen), other than a corporation, outside the United States having no legal residence or principal place of business in any internal revenue district, or the return of a corporation having no principal place of business or principal office or agency in any internal revenue district, shall be filed with the Director, Foreign Operations District, Internal Revenue Service, Washington, D.C. 20225. If, however, the principal place of business or legal residence of the person, or the principal place of business or principal office or agency of the corporation, is located in the Virgin Islands or Puerto Rico, the return shall be filed with the Director of International Operations, U.S. Internal Revenue Service, Hato Rey, Puerto Rico 00917.

(d) *Returns filed with service centers.* Notwithstanding paragraphs (a), (b), and (c) of this section, whenever instructions applicable to any returns provide that the returns shall be filed with a service center, the returns shall be so filed in accordance with the instructions.

(e) *Hand-carried returns.* Except as provided in paragraph (e)(3) of this section, and notwithstanding paragraphs (1) and (2) of section 6091(b) and paragraph (d) of this section, the following rules apply.

(1) *Persons other than corporations.* Returns of persons other than corporations which are filed by hand carrying shall be filed with the district director as provided in paragraph (a) of this section.

(2) *Corporations.* Returns of corporations which are filed by hand carrying shall be filed with the district director as provided in paragraph (b) of this section.

(3) *Exceptions.* This paragraph (e) shall not apply to returns of—

(i) Persons who have no legal residence, no principal place of business, or no principal office or agency in any internal revenue district.

(ii) Citizens of the United States whose principal place of abode for the period with respect to which the return is filed is outside the United States.

(iii) Persons who claim the benefits of section 911 (relating to income earned by individuals from sources without the United States), section 913 (relating to deduction for certain expenses of living abroad), section 931 (relating to income from sources within possessions of the United States), section 933 (relating to income from sources within Puerto Rico), or section 936 (relating to Puerto Rico and possession tax credit), and

(iv) Nonresident alien persons and foreign corporations.

(f) *Permission to file in district other than required district.* The Commissioner may permit the filing of any return required to be made under the regulations in this part in any internal revenue district, notwithstanding the provisions of paragraphs (1), (2),and (4) of section 6091(b) and paragraphs (a), (b), (c), (d), and (e) of this section.

(g) *Cross reference.* For definition of the term "hand carried", see §301.6091-1(c) of this chapter (Regulations on Procedure and Administration).

Par. 13. The following new §48.6101-1 is added immediately after §48.6091-1.

§48.6101 1 Period covered by returns or other documents.

The normal period for which returns are ordinarily required under this subpart is a calendar quarter. Under certain circumstances, however, the district director may require returns to be filed for monthly or semimonthly periods. For provisions relating to quarterly returns, see §48.6011(a)-1(a). For provisions relating to monthly and semimonthly returns, see §48.6011(a)-1(b).

Par. 14. Section 48.6109-1 is revised to read as follows:

§48.6109-1 Employer identification numbers.

(a) *Requirement of application*—(1) *In general.* An application on Form SS-4 for an employer identification number shall be made by every person who makes a sale or use of an article with respect to which a tax is imposed by section 4041, 4042 or 4051 or chapter 32 of the Code, but who has not earlier been assigned an employer identification number or has not applied

for one. The application and any supplementary statement accompanying it shall be prepared in accordance with the applicable form, instructions, and regulations and shall set forth fully and clearly the date therein called for. Form SS-4 may be obtained from any district director or director of a service center. The application shall be filed with the internal revenue officer designated in the instructions applicable to Form SS-4. The application shall be signed by (i) the individual if the person is an individual; (ii) the president, vice-president, or other principal officer, if the person is a corporation; (iii) a responsible and duly authorized member or officer having knowledge of its affairs, if the person is a partnership or other unincorporated organization; or (iv) the fiduciary, if the person is a trust or estate. An employer identification number will be assigned to the person in due course upon the basis of information reported on the application required under this section.

(2) *Time for filing Form SS-4.* The application for an employer identification number shall be filed on or before the seventh day after the date of the fist sale or use of an article with respect to which a tax is imposed by section 4041, 4042, or 4051 or chapter 32 of the Code.

(b) *Use of employer identification number.* The employer identification number assigned to a person liable for a tax imposed by section 4041, 4042, or 4051 or chapter 32 of the Code shall be shown in any return, statement, or other document submitted to the Internal Revenue Service by the person.

(c) *Cross references.* For the definition of the term "employer identification number", see §301.7701-12 of this chapter (Regulations on Procedure and Administration). For provisions relating to the penalty for failure to include the employer identification number in a returned statement, or other document, see §301.6676-1 of this chapter (Regulations on Procedure and Administration).

Par. 15. Section 48.6151-1 is revised to read as follows:

§48.6151-1 Time and place for paying tax shown on return.

The tax required to be reported on each tax return under this subpart is due and payable to the internal revenue officer with whom the return is filed at the time prescribed in §48.6071(a)-1 for filing such return. See the applicable sections in Part 301 of this chapter (Regulations on Procedure and Administration) for provisions relating to interest on underpayments, additions to tax, and penalties. For provisions relating to the use of Federal Reserve banks and authorized financial institutions in depositing the taxes, see §48.6302(c)-1.

Par. 16. The following new §48.6161(a)-1 is added immediately after §48.6151-1.

§48.6161(a)-1 Extension of time for paying tax shown on return.

(a) *In General.* (1) Ordinarily, no extensions of time will be granted for payment of any tax imposed by section 4041, 4042 or 4051 or chapter 32 of the Code, and shown or required to be shown on any return. However, if because of temporary conditions beyond the taxpayer's control a taxpayer believes an extension of time for payment is justified, the taxpayer may apply to the district director, or to the director of the service center, for an extension. The period of any extension shall not be in excess of 6 months from the date fixed for payment of the tax, except that if the taxpayer is abroad the period of the extension may be in excess of 6 months.

(2) The granting of an extension of time for filing a return does not operate to extend the time for the payment of the tax or any part of the tax unless so specified in the extension. See §48.6081(a)-1.

(b) *Undue hardship required for extension.* An extension fo the time for payment shall be granted only upon a satisfactory showing that payment on the due date of the amount with respect to which the extension is desired will result in an undue hardship. The extension will not be granted upon a general statement of hardship. The term "undue hardship" means more than an inconvenience to the taxpayer. It must appear that substantial financial loss, for example, loss due to the sale of property at a sacrifice price, will result to the taxpayer from making payment on the due date of the amount with respect to which the extension is desired. If a market exists, the sale of property at the current market price is not ordinarily considered as resulting in an undue hardship.

(c) *Application for extension.* An application for an extension of time for payment of the tax shown or required to be shown on any return shall be made on Form 1127 and shall be accompanied by evidence showing the undue hardship that would result to the taxpayer if the extension were refused. The application shall also be accompanied by a statement of the assets and liabilities of the taxpayer and an itemized statement showing all receipts and disbursements for each of the 3 months immediately preceding the due date of the amount to which the application relates. The application, with supporting documents, must be filed, on or before the date prescribed for payment of the amount with respect to which the extension is desired, with the internal revenue officer to whom the tax is to be paid. The application will be examined, and within 30 days, if possible, will be denied, granted, or tentatively granted subject to certain conditions of which the taxpayer will be notified. If an additional extension is desired, the request for it must be made on or before the expiration of the period for which the prior extension is granted.

(d) *Payment pursuant to extension.* If an extension of time for payment is granted, the payment shall be made on or before the expiration of the period of the extension without the necessity of notice and demand. The granting of an extension of time for payment of the tax does not relieve the taxpayer from liability for the payment of interest on the tax during the period of the extension. See section 6601 and §301.6601-1 of this chapter (Regulations on Procedure and Administration).

Par. 17. Section 48.6206-1 is revised to read as follows.

§48.6206-1 Assessment and collection of excessive payment and penalty.

(a) *Treatment of excessive amount as tax.* If any portion of a payment made under section 6420 (relating to gasoline used on farms), section 6421 (relating to gasoline used for certain nonhighway purposes or by local transit systems), section 6424 (relating to lubricating oil

sold prior to January 7, 1983, and not used in highway motor vehicles), or section 6427 (relating to special fuels not used for taxable purposes) constitutes an excessive amount as defined in section 6675(b) and §48.6675-1(b), the excessive amount and any civil penalty provided by section 6675 may be assessed and collected by the district director—

(1) As if the excessive amount and civil penalty were a tax imposed by section 4081 (relating to tax on the sale of gasoline), section 4091 (relating to tax on sale of lubricating oil prior to January 7, 1983), or section 4041 (relating to tax on sale of special fuels), as the case may be, and

(2) As if the person who made the claim for payment were liable for tax imposed by section 4081, 4091 or 4041, in that amount.

(b) *Assessment period.* The period within which the portion of a payment constituting an excessive amount and any civil penalty may be assessed shall be 3 years from the last date prescribed by section 6420, 6421, 6424 or 6427, as the case may be, for the filing of the claim in respect of which the excessive amount is attributable.

Par. 18. Section 48.6302(c)-1 is revised to read as follows:

§48.6302(c)-1 Use of Government depositaries.

(a) *Monthly deposits.* Except as provided in paragraph (b) of this section, if for any calendar month (other than the last month of a calendar quarter) any person required to file a quarterly excise tax return on Form 720 has a total liability under this part of more than $100 for all excise taxes reportable on that form, the amount of liability for taxes shall be deposited by the person with a Federal Reserve bank or authorized financial institution on or before the last day of the month following the calendar month.

(b) *Semimonthly deposits.* (1) If any person required to file an excise tax return on Form 720 for any calendar quarter has a total liability under this part of more than $2,000 for all excise taxes reportable on that form for any calendar month in the preceding calendar quarter, the amount of that liability for taxes under this part for any semimonthly period (as defined in paragraph (d)(1) of this section) in the succeeding calendar quarter shall be deposited by the person with a Federal Reserve bank or authorized financial institution on or before the depository date (as defined in paragraph (d)(2) of this section) applicable to the semimonthly period.

(2) A person will be considered to have complied with the requirements of paragraph (b)(1) of this section for a semimonthly period if—

(i)(A) The person's deposit for the semimonthly period is not less than 90 percent of the total amount of the excise taxes reportable by the person on Form 720 for the period, and

(B) If the semimonthly period occurs in a calendar month other than the last month in a calendar quarter, the person deposits any underpayment for the month by the 9th day of the second month following the calendar month; or

(ii)(A) The person's deposit for each semimonthly period in the calendar month is not less than 45 percent of the total amount of the excise taxes reportable by the person on Form 720 for the month, and

(B) If such month is other than the last month in a calendar quarter, the person deposits any underpayment for such month by the 9th day of the second month following the calendar month; or

(iii)(A) The person's deposit for each semimonthly period in the calendar month is not less than 50 percent of the total amount of the excise taxes reportable by the person on Form 720 for the second preceding calendar month, and

(B) If such month is other than the last month in a calendar quarter, the person deposits any underpayment for such month by the 9th day of the second month following the calendar month; or

(iv)(A) The requirements of paragraph (b)(2)(i)(A), (ii)(A), or (iii)(A) of this section are satisfied for the first semimonthly period of a calendar month after January 1971,

(B) If the person's deposit for the second semimonthly period of the calendar month is, when added to the deposit for the first semimonthly period, not less than 90 percent of the total amount of the excise taxes reportable by the person on Form 720 for the calendar month, and

(C) If the semimonthly periods occur in a calendar month other than the last month in a calendar quarter, the person deposits any underpayment for the month by the 9th day of the second month following the calendar month.

(3)(i) Paragraph (b)(2)(ii) and (iii) of this section shall not apply to any person who normally incurs in the first semimonthly period in each calendar month more than 75 percent of the person's total excise tax liability under this part for the month.

(ii) Persons who make their deposits in accordance with paragraph (b)(2)(ii), (iii), or (iv) of this section will find it unnecessary to keep their books and records on a semimonthly basis.

(c) *Deposit of certain excess undeposited amounts.* Notwithstanding paragraphs (a) and (b) of this section, if any person required to file an excise tax return on Form 720 for any calendar quarter beginning after March 31, 1968, has a total liability under this part of all excise taxes reportable on the form for the calendar quarter which exceeds by more than $100 the total amount of taxes deposited by the person pursuant to paragraph (a) or (b) of this section for the calendar quarter, the person shall, on or before the last day of the calendar month following the calendar quarter for which the return is acquired to be filed, deposit with a Federal Reserve bank or authorized financial institution the full amount by which the person's liability for all excise taxes reportable on the form for that calendar quarter exceeds the amount of excise taxes previously deposited by the person for that calendar quarter.

(d) *Definitions.* For purposes of this part—

(1) *Semimonthly period.* The term "semimonthly period" means the first 15 days of a calendar month or the portion of a calendar month following the 15th day of that month.

(2) *Depositary date.* (i) The term "depositary date" means, in the case of deposits for semimonthly periods beginning after January 31, 1971, the 9th day of the semimonthly period following the semimonthly period for which the taxes are reportable.

(ii) The term "depositary date" means, in the case of deposits for semimonthly periods ending before Febru-

ary 1, 1971, the last day of the semimonthly period following the semimonthly period for which the taxes are reportable.

(iii) The term "depositary date" means, in the case of deposits by qualified persons whose liability for tax under section 4081 arises after March 31, 1983, and is payable with respect to semimonthly periods, 14 days after the close of the semimonthly period if payment is made either by wire transfer to any government depositary authorized under section 6302 or by transfer between accounts in the same government depositary. See §145.3-1 (relating to extension of payment due date for certain fuel taxes) and section 518 of the Highway Revenue Act of 1982 (96 Stat. 2184).

(e) *Depositary forms and procedures*—(1) *In general.* A person required by this section to make deposits may make one or more remittances with respect to the amount required to be deposited. An amount of tax which is not otherwise required by this section to be deposited may, nevertheless, be deposited if the person liable for the tax so desires.

(2) *Deposits for 1968 and subsequent years.* Each remittance of amounts required to be deposited for periods subsequent to 1967 shall be accompanied by a Federal Tax Deposit form, which shall be prepared in accordance with the applicable instructions. The remittance, together with the Federal Tax Deposit form, shall be forwarded to a financial institution authorized as a depositary for Federal taxes in accordance with 31 CFR Part 214 or, at the election of the person making the remittance, to a Federal Reserve Bank. For procedures governing the deposit of Federal taxes at a Federal Reserve Bank, see 31 CFR Part 214.7. The timeliness of the deposit will be determined by the date it is received (or is deemed received under section 7502(e) and §301.7502-1 of this chapter (Regulations on Procedure and Administration)) by the Federal Reserve Bank or by the authorized financial institution. Amounts deposited pursuant to this paragraph (e)(2) shall be considered to be paid on the last day prescribed for filing the return in respect of the tax (determined without regard to any extension of time for filing the returns), or at the time deposited, whichever is later.

(3) *Information required.* Each person making deposits pursuant to this section shall report on the return for the period with respect to which the deposits are made information regarding the deposits in accordance with the instructions applicable to the return and pay (or deposit by the due date of the return) the balance, if any, of the taxes due for the period.

(4) *Procurement of prescribed forms.* Copies of the Federal Tax Deposit form will be furnished, so far as possible, to persons required to make deposits under this section. Such a person will not be excused from making a deposit, however, by the fact that no form has been furnished. A person not supplied with the form is required to apply for it in ample time to make the required deposits within the time prescribed, supplying with the application the person's name, identification number, address, and the taxable period to which the deposits will relate. Copies of the Federal Tax Deposit form may be obtained by applying for them with the distinct director or the director of a service center.

(f) *Nonapplication to certain taxes.* This section does not apply to taxes for (1) any month or semimonthly period in which the taxpayer receives notice from the district director pursuant to §48.6011(a)-1(b) to file Form 720 or (2) any subsequent month or semiannually period for which a return on Form 720 is required.

Par. 19. The following new §48.6302(c)-2 is added immediately after §48.6302(c)(1).

§48.6302(c)-2 Cross reference.

(a) *Failure to deposit.* For provisions relating to failure to make a deposit within the time prescribed, see §301.6656-1 of this chapter (Regulations on Procedures and Administration).

(b) *Saturday, Sunday, or legal holiday.* For regulations relating to the time for performance of acts when the last day for the performance falls on a Saturday, Sunday or legal holiday, see §301.7503-1 of this chapter (Regulations on Procedure and Administration). See §145.3-1(d) and section 518 of the Highway Revenue Act of 1982 (96 Stat. 2184) relating to the depositary date for persons required to make semimonthly deposits under section 4081 when the last day for performance falls on a Saturday, Sunday or legal holiday in the District of Columbia.

Par 20. The following new §§48.6402(a)-1, 48.6404(a)-1, 48.6412-1, 48.6412-2 and 48.6412-3 are added immediately after §48.63402(c)-2.

§48.6402(a)-1 Authority to make credits or refunds.

For provisions relating to credits and refunds of certain taxes on sales and services see section 6416 and the regulations thereunder. For regulations under section 6402 of general application in respect of credits or refunds, see §§301.6402-1, 301-6402-2, and 301.6402-4 of this chapter (Regulations on Procedure and Administration).

§48.6404(a)-(1) Abatements.

For regulations under section 6404 of general application in respect of abatements of assessments of tax, see §301.6404-1 of this chapter (Regulations on Procedure and Administration).

§48.6412-1 Floor stocks credit or refund.

(a) *In general.* This section sets forth the procedures to be followed in claiming the credit or refund authorized by section 6412 for manufacturers excise taxes paid in respect of certain articles held by dealers as floor stocks on October 1, 1988. See §48.6412-2 for definitions of the following terms when used in this section: "floor stocks", "inventory date", "dealer", "held by a dealer", "old rate", "new rate", "dealer request limitation date", "claim limitation," and "tax paid". See §48.6412-3 for determining the amount of tax paid on articles that are held as floor stocks. The manufacturers excise taxes for which credit or refund may be claimed under this section are those imposed by section 4071, relating to tires of the type used on highway vehicles; and section 4081, relating to gasoline. For definition of the term "highway vehicle", see §48.4061(a)-1(d).

(b) *Computation of the amount of floor stocks credit or refund.* the amount of floor stocks credit or refund which may be claimed by the manufac-

turer under section 6412(a)(1) may not exceed an amount equal the difference between the tax paid by the manufacturer on the sale of the article and the amount of tax made applicable to the article on the inventory date. No interest is allowable with respect to any amount of tax credited or refunded under section 6412 and this section. In applying the floor stocks credit or refund provisions, the date on which the manufacturer paid the tax with respect to the article held as floor stocks is not relevant. Thus, the period of limitations provided in section 6511 with respect to claims for credit or refund does not apply; however, see paragraph (f) of this section. For definition of the term "manufacturer", see §48.0-2(a)(4).

(c) *Limitation.* Except as provided in §48.6412-3, no credit or refund is allowable under this section for an amount paid as tax which may be credited or refunded under any provisions of law other than section 6412(a)(1), or which was allowable as a credit or refund under section 6412 with respect to an earlier inventory date.

(d) *Relationship between credits or refunds for floor stocks and credits or refunds for price readjustments.* the amount which may be credited or refunded for floor stocks and for price readjustments on an article may not in the aggregate exceed the tax paid in respect of the article. A credit or refund computed on the basis of the old tax rate will be allowed with respect to a price readjustment of an article on which a floor stock credit or refund was allowed, but only if the amount of the floor stock credit or refund otherwise allowable was reduced by taking into account such price readjustment, as determined under §48.6412-3(e). The manufacturer must keep readily available for inspection sufficient records to enable examining officers of the Internal Revenue Service to ascertain the correctness of any claim for credit or refund for a price readjustment of an article on which a floor stock refund was claimed.

(e) *Participation of dealers*—(1) *Request by dealer.* On or before the dealer request limitation date, a dealer may submit to a manufacturer a request with respect to a credit or refund allowable under this section for tax paid by the manufacturer with respect to articles held by the dealer as floor stocks. This request may be submitted directly to the manufacturer, or it may be submitted to him indirectly through another dealer in the distribution chain if the request is received by the manufacturer or an unauthorized agent of the manufacturer on or before the dealer request limitation date.

(2) *Requirements for claim by manufacturer.* No amount of credit or refund under this section may be claimed by a manufacturer with respect to articles held by a dealer as floor stocks unless—

(i) The claim for the amount is based upon a request submitted by the dealer to the claimant on or before the dealer request limitation date;

(ii) The amount is paid by the claimant to the dealer, or the dealer's written consent to allowance of the credit or refund has been received by the claimant, on or before the claim limitation date; and

(iii) The request by the dealer is supported by an inventory statement, made under the penalties of perjury and signed by the dealer or by the dealer's authorized representative, setting forth the following information:

(A) The name and address of the dealer and of the applicable manufacturer, (if the name and address of the applicable manufacturer is unknown to the dealer, these items may be added by any person in the chain of distribution);

(B) The identification number, if any, of the article, such as a serial stock, model, type, or class number, or some other suitable means of identification;

(C) A brief description of the article, such as its common name or designation; and

(D) The quality of articles held by the dealer as floor stocks on the inventory date.

(3) *Actual manufacturer unknown.* If a dealer addresses a request to the person, who from markings on the article the dealer presumes to be the manufacturer, the request may be treated as made to the actual manufacturer if the actual manufacturer accepts the dealer's request.

(4) *Payment to dealer by claimant.* Payment may be made directly to the dealer or to the dealer's authorized agent or representative by the claimant or by the claimant's authorized agent or representative. If a claimant pays a dealer through the claimant's agent or representative, the evidence must show that the dealer actually received the payment. If a dealer authorized the claimant to pay the dealer through the dealer's agent or representative, evidence showing receipt of the payment by the agent or representative will be accepted as proof of actual payment to the dealer. Payment shall be made, at the manufacturer's option, in cash, by check, or by credit to the dealer's account as maintained by the claimant. The amount of the payment which may be made by crediting the dealer's account may not exceed the undisputed debit balance due at the time the credit is made. However, payment may be made in merchandise at the dealer's option with the concurrence of the manufacturer.

(5) *Date of performance.* The date on which any act described in this paragraph (e) is performed by an agent or representative on behalf of a claimant or dealer is deemed to be the date on which the act is performed by the principal.

(6) *Record of inventories.* For provisions relating to the record of a dealer's inventories to be kept by the claimant, see paragraph (g) of this section.

(7) *Sample written consent.* No particular form is prescribed or required for the written consent of the dealer described in paragraph (e)(2)(ii) of this section. However, the following is an example of an acceptable consent statement by a dealer:

Consent Statement of Dealer

(For use by dealer in requesting manufacturer, producer, or importer to obtain credit under section 6412 of the Internal Revenue Code of 1954 with respect to floor stocks.)

I hereby consent to the allowance to the manufacturer, producer, or importer of the floor stocks credit or refund of the excise tax imposed by the Internal Revenue Code of 1954 with respect to the articles in my inventory on _____

_____

(Name)

By _____

(Signature of Officer)

_____

(Title)

_____

(Date)

(f) *Procedure for claiming credit or refund*—(1) *In general.* Each claim for

credit or refund under this section shall be filed on or before the applicable claim limitation date, in the manner and subject to the conditions stated in this section and in §301.6402-2 of this chapter (Regulations on Procedure and Administration). Either credit or refund, or a combination thereof, may be claimed, but the amount which may be claimed as a credit on a return shall not exceed the total tax liability shown on the return, reduced by the amount of any deposits made under §48.6302(c)-1 with respect to the return and by any amount of credit claimed on the return pursuant to any provision of law other than section 6412. If the total amount which may be claimed exceeds the amount that may be claimed as credit on a return, the excess amount may be claimed on or before the applicable claim limitation date either as a refund or as a credit on a subsequent return. If credit is claimed the amount of the credit shall be entered as a credit on a timely-filed return of tax. The statement described in paragraph (f)(2) of this section must show the amount and date of each previous and concurrent claim for credit or refund under this section and indicate whether any future claims are expected to be filed.

(2) *Supporting evidence to be submitted by the manufacturer.* No credit or refund shall be allowed under this section unless there is submitted, in support of the claim for credit or refund, a statement signed by the person making the claim, that describes in general terms the articles covered by the claim, sets forth the method of computing the amount claimed (including a description of any procedures used pursuant to §48.6412-3), and states that—

(i) The claimant paid to the district director or the director of the internal revenue service center the tax for which credit or refund is claimed;

(ii) The total amount claimed represents payments requested by dealers before the dealer request limitation date;

(iii) The total amount claimed either was paid by the claimant to the dealers, or the claimant received the written consent of the dealers to the allowance of the amount claimed;

(iv) The claimant has in his possession, and available for inspection by internal revenue officers, the evidence with respect to inventories required by paragraph (g)(2) of this section, and any written consents referred to in paragraph (f)(2)(iii) of this section; and

(v) No other claim for credit or refund under this section has been or will be made by the claimant with respect to any amount covered by the claim.

(g) *Evidence to be retained in the manufacturer's records.* Every person filing a claim for credit or refund pursuant to this section shall support the claim by keeping as part of the claimant's records—

(1) The dealer's inventory statements required by paragraph (e)(2)(iii) of this section, to the extent that the articles are covered by the claim;

(2) Records, in respect of the articles held by each dealer, showing—

(i) The name and address of the dealer,

(ii) The quantities of each article held by the dealer as floor stocks by taxable category, for example, by model or type number,

(iii) The amount of tax considered to be paid by the manufacturer with respect to each article held by the dealer, as determined under §48.6412-3,

(iv) The amount of tax, if any, which the claimant would pay on the sale of each article held by the dealer if the tax were computed at the new rate,

(v) The total amount of reimbursement due the dealer,

(vi) The date on which the claimant received from the dealer the request described in paragraph (e)(1) of this section, but only if payment was not made to the dealer before the dealer request limitation date, and

(vii) the date and amount of each payment to a dealer, or the date of receipt by the claimant from the dealer of a written consent, as set forth in paragraph (e)(2)(ii) of this section; and

(3) Any such written consent received from a dealer.

(h) *Special rules where the presumed manufacturer is the agent of the actual manufacturer.* For purposes of this section, if a manufacturer sells articles tax-paid to a second manufacturer for resale by the second manufacturer under its own brand name, the second manufacturer may perform any acts and keep any records which are a prerequisite to the first manufacturer's filing a claim for floor stocks credit or refund wit respect to the articles. If such a proce dure is followed, the claim filed by th first manufacturer shall include a state ment indicating the name and addres of the second manufacturer and th amount of its claim which relates to ar ticles sold to the second manufacturer

(i) *Effect on other claims for credi or refund.* If a claim for credit or re fund is made pursuant to section 641(and the regulations thereunder, relatin in part to returned sales, sales for ex port or for exempt use, sales to States etc., with respect to a tax imposed by section 4071 or section 4081, and if the claim is made with respect to articles sold by the claimant before the date on which the tax is reduced in rate or ter minated, the claim shall be based on the new rate of tax unless the claiman can establish that the tax was imposed at the old rate and that no refund o credit under this section was allowed with respect to the articles. See, how ever, paragraph (d) of this section.

(j) *Other applicable provisions.* Al provisions of law, including penalties applicable in respect of the taxes imposed by sections 4071, 4081 and shall, insofar as applicable and not in consistent with section 6412, apply in respect to the credits and refunds pro vided for in section 6412 to the same extent as if the credits or refunds con stituted overpayments of the taxes. Fo provisions under which timely mailing is treated as timely filing, and for pro visions applicable to the time for per formance of acts when the last day falls on Saturday, Sunday, or a legal holi day, see §§301.7502-1 and 301.7503-1, respectively, of this chap ter (Regulations on Procedure and Administration).

§48.6412-2 Definitions for purposes o floor stocks credit or refund.

For purposes of section 6412 and th regulations thereunder—

(a) *Floor stocks.* The term "floo stocks" means any article subject to th tax imposed by section 4071 or sectio 4081 which—

(1) Is sold by the manufacturer (ot erwise than in a tax-free sale) befor October 1, 1988,

(2) Is held by a dealer at the firs moment on October 1, 1988, and ha not been used, and

(3) Is intended for sale.

However, the term "floor stocks" does not include gasoline in retail stocks held at the place where intended to be sold at retail, nor with respect to gasoline held for sale by a producer or importer of gasoline.

(b) *Inventory date.* The term "inventory date" means the first moment on the date on which an article is treated as floor stocks within the meaning of paragraph (a) of this section.

(c) *Dealer.* The term "dealer" includes a wholesaler, jobber, distributor, or retailer.

(d) *Held by a dealer*—(1) *In general.* (i) An article is considered as "held by a dealer" if title to the article has passed to the dealer (whether or not delivery to the dealer has been made), and if, for purposes of consumption, title to or possession of the article has not at any time been transferred to any person other than a dealer.

(ii) Floor samples, demonstrators, and articles undergoing repair (whether or not on the dealer's premises) that are carried in stock to be sold as new articles, and articles purchased tax-paid by manufacturer or a sales subsidiary and held by the person on the inventory date for resale as such, will be considered as unused and held by a dealer, if title to or possession of the article has not at any time been transferred to any person for purposes of consumption.

(iii) Articles sold by a dealer to a consumer before the inventory date and thereafter repossessed by the dealer, and articles purchased tax-paid by a manufacturer for use in further manufacture within the meaning of section 4221(d)(6), will not be considered as held by a dealer.

(iv) The determination as to the time title or possession passes for purposes of consumption shall be made under applicable local law.

(2) *Examples.* The application of this paragraph (d) may be illustrated by the following examples:

Example (1). If, under local law, title to an article sold by a dealer under a conditional sales contract is in the dealer on the inventory date, but the consumer has physical possession fo the article on that date, the article is not considered as held by the dealer.

Example (2). If, under local law, title to an article is in the consumer on the inventory date because the article is specifically identified with a contract, but on that date the dealer still has physical possession fo the article, for example, in his will-call department, the article is not considered as held by the dealer on that date because title to the article has passed to the consumer for purposes of consumption.

Example (3). If, under local law, title to an article is in the consumer on the inventory date because the dealer transferred the article to a common carrier for delivery to the consumer, the article in transit is not considered as held by the dealer on that date because title has passed to the consumer for purposes of consumption, even though neither the dealer nor the consumer has physical possession fo the article.

Example (4). If under local law, title to an article is in the dealer on the inventory date and does not pass to the consumer until delivery by a common carrier, the article in transit shall be considered as held by the dealer on that date because neither the title nor possession has passed to the consumer for purposes of consumption.

Example (5). If an article has been mortgaged or otherwise hypothecated by a dealer as security for a loan and, under local law, title to the article is in the creditor on the inventory date, and physical possession is in the dealer, the article shall be considered as held by the dealer on that date because neither title nor possession has passed to the consumer for purposes of consumption.

(e) *Old rate.* The term "old rate" means the rate of tax in effect with respect to the sale of an article before the date designated in paragraph (a) or (b) of this section on which the tax is reduced in rate or is terminated.

(f) *New rate.* The term "new rate" means the rate of tax, if any, in effect with respect to the sale of an article on the date designated in paragraph (a) or (b) of this section on which the tax is reduced in rate or is terminated.

(g) *Dealer request limitation date.* The term "dealer request limiation date" is the date prescribed by section 6412(a)(1) before which the request on which the manufacturer's claim is based must be submitted to the manufacturer by the dealer who held the floor stocks on the inventory date. In the case of an article held by a dealer on October 1, 1988, the dealer request limitation date is January 1, 1989.

(h) *Claim limitation date.* The term "claim limitation date" means the last date prescribed by section 6412(a)(1) on which refund or credit with respect to floor stocks may be claimed by a manufacturer. In the case of an article held by a dealer on October 1, 1988, the claim limitation date is March 31, 1989.

(i) *Tax paid.* A tax is considered paid if it was paid or was offset by an allowable credit on the return on which it was reported.

§48.6412-3 Amount of tax paid on each article.

(a) *General rule.* For purposes of making the claim for credit or refund under §48.6412-1 in respect of floor stocks held by a dealer, the tax paid on each article must be separately computed. If desired, the procedures set forth in paragraphs (b) through (g) of this section may be used in making the computation. The procedure used in determining the tax paid on an article must also be used in determining the amount of tax, if any, made applicable to the article on the effective date of reduction of repeal of the tax involved. Prior approval of the Internal Revenue Service for the method of computation need not be obtained and should not be requested.

(b) *Selling price.* In determining the price of an article on which the tax paid is to be computed, the average of the gross selling prices of identical articles sold during a representative period may be used. For example, truck chassis of the same model that are sold by the manufacturer with the same equipment and accessories are identical articles whose selling prices may be computed on the basis of an average.

(c) *Transportation charges.* In determining the price of an article on which the tax paid is to be computed, the average of the exclusions authorized by section 4216(a) for transportation, delivery, insurance, installation, etc., for a reasonable category of articles during a representative period may be used.

(d) *Credits for tax paid on inner tubes.* The average of the credits authorized by section 6416(c) for tax paid on tires or inner tubes may be averaged for a reasonable category of articles during a representative period. The credits shall be subtracted from the gross excise tax to arrive at the net excise tax paid.

(e) *Price readjustments.* (1) In determining the price on which the tax paid is to be computed, there must be taken into account any price readjustments with respect to which the manufacturer has filed a claim for credit or refund under section 6416(b). Other price readjustments which have been, or are reasonably expected to be, made with respect to the article may, at the option of the manufacturer, be taken into account in computing the price of the article.

(2) Price readjustments which cannot be attributed to specific articles as of the inventory date (as, for example, a price readjustment of a flat dollar amount which is made to dealers who meet a sales quota) may be taken into account on the basis of an average of the adjustments which is computed for a reasonable category of articles over a representative period.

(3) Price readjustments related to specific items (as, for example, an automatic rebate of a specific percentage of the price of each unit sold to a dealer) may not be average, and in such a case only the actual price readjustment attributable to a particular article may be taken into account in computing the tax on that article.

(4) If, because of the facts in a case, a price readjustment can be attributed to specific articles for purposes of consumer refunds but cannot be attributed to specific articles for purposes of floor stocks credits or refunds, the price adjustment may be averaged for purposes of both consumer refunds and floor stocks credits and refunds.

(f) *Representative period.* A period will be considered a representative period if—

(1) It covers (i) at least four consecutive calendar quarters, the last of which ends with a period of six calendar months immediately preceding the effective date of the tax reduction or repeal involved or (ii) any other period of time which the taxpayer can demonstrate constitutes a representative period for the particular category, and

(2) The number of articles in the category involved sold by the manufacturer during the period either (i) equals or exceeds the number of articles in the category to which the average amount is to be applied or (ii) can be demonstrated by the taxpayer to be a representative quantity.

(g) *Reasonable category.* Examples of a reasonable category of articles are articles that are identified by a common stock or class number or which are of the same model, class, or line. For the purpose of averaging exclusions, another example of a reasonable category of articles is a grouping of articles that are shipped in the same container. If a manufacturer sells articles bearing his own trademark and also sells articles as private brands, separate computations of the two brands must be made under this section.

Par. 21. Section 48.6416(a)-1 is revised to read as follows:

§48.6416(a)-1 Claims for credit or refund of overpayments of taxes on special fuels and manufacturers taxes.

Any claims for credit or refund of an overpayment of a tax imposed by chapter 31 or chapter 32 shall be made in accordance with the applicable provisions of this subpart and the applicable provisions of §301.6402-2 of this chapter (Regulations on Procedure and Administration). A claim on Form 843 is not required in the case of a claim for credit, but the amount of the credit shall be claimed by entering that amount as a credit on a return of tax under this subpart filed by the person making the claim. In this regard, see §48.6416(f)-1.

Par. 22. The following new §§48.6416(a)-2 and 48.6416(a)-3 are added immediately after §48.6416(a)-1 to read as follows.

§48.6416(a)-2 Credit or refund of tax on special fuels.

(a) *Overpayments not described in section 6416(b)(2)*—(1) *Claims included.* This paragraph applies only to claims for credit or refund of an overpayment of tax imposed by section 4041(a)(1)(A) (relating to tax on the sale of diesel fuel), section 4041(a)(2)(A) (relating to tax on the sale of special motor fuels), section 4041(c)(1)(A) (relating to tax on the sale of fuel for use in noncommercial aviation), or section 4041(c)(2)(A) (relating to the tax on sale of gasoline for use in noncommercial aviation). It does not apply, however, to a claim for credit or refund of any overpayment described in paragraph (b) of this section which arises by reason of the application of section 6416(b)(2).

(2) *Supporting evidence required.* No credit or refund of any overpayment to which this paragraph (a) applies shall be allowed unless the person who paid the tax submits with the claim a written consent of the ultimate purchaser to the allowance of the credit or refund, or submits with the claim a statement, supported by sufficient available evidence, asserting that—

(i) The person has neither included the tax in the price of the fuel with respect to which it was imposed nor collected the amount of the tax from a vendee, and identifying the nature of the evidence available to establish these facts, or

(ii) The person has repaid the amount of the tax to the ultimate purchaser of the fuel.

(3) *Ultimate purchaser.* The term "ultimate purchaser", as used in paragraph (a)(2) of this section, means the vendee to whom the fuel was sold tax-paid by the person claiming credit or refund.

(b) *Overpayments determined under section 6416(b)(2)*—(1) *Claims included.* This paragraph applies only to claims for credit or refund of amounts paid as tax under section 4041(a)(1)(A) (relating to tax on the sale of diesel fuel) or section 4011(a)(2)(A) (relating to tax on the sale of special motor fuels) that are determined to be overpayments by reason of section 6416(b)(2) (relating to tax payments in respect of certain uses, sales, or resales of a taxable article).

(2) *Supporting evidence required.* No credit or refund of an overpayment to which this paragraph (b) applies shall be allowed unless the person who paid the tax submits with the claim a statement, supported by sufficient available evidence, asserting that—

(i) The person has neither included the tax in the price of the fuel with respect to which it was imposed nor collected the amount of the tax from the vendee and identifying the nature of the evidence available to establish the facts, or

(ii) The person has repaid, or agreed to repay, the amount of the tax to the ultimate vendor of the fuel, or

(iii) The person has secured, and will submit upon request of the Service, the written consent of the ultimate vendee to the allowance of the credit or refund.

(3) *Ultimate vendor.* The term "ultimate vendor", as used in paragraph (b)(2) of this section, means the seller making the sale which gives rise to the overpayment or which last precedes the exportation or use which gives rise to the overpayment.

(c) *Nonapplication to tax on use of special fuels.* This section shall not have any effect on overpayments of tax under section 4041(a)(1)(B) (relating

tax on the use of diesel fuel), section 4041(a)(2)(B) (relating to tax on the use of special motor fuels), section 4041(c)(1)(B) (relating to tax on the use of fuel other than gasoline in noncommercial aviation), section 4041(c)(2)(B) (relating to tax on the use of gasoline in noncommercial aviation), or section 4042 (relating to tax on fuel used in commercial transportation on inland waterways).

§48.6416(a)-3 Credit or refund of manufacturers tax under chapter 32.

(a) *Overpayments not described in section 6316(b)(3)(C) or (4) (prior to April 1, 1983) and section 6416(b)(2)*—(1) *Claims included.* This paragraph applies only to claims for credit or refund of an overpayment of manufacturers tax imposed by chapter 32. It does not apply, however, to a claim for credit or refund on any overpayment described in paragraph (b) of this section which arises by reason of the application of section 6416(b)(2), (3)(C), or (4).

(2) *Supporting evidence required.* No credit or refund of any overpayment to which this paragraph (a) applies shall be allowed unless the person who paid the tax submits with the claim a written consent of the ultimate purchaser to the allowance of the credit or refund, or submits with the claim a statement, supported by sufficient available evidence, asserting that—

(i) The person has neither included the tax in the price of the article with respect to which it was imposed nor collected the amount of the tax from a vendee, and identifying the nature of the evidence available to establish these facts, or

(ii) The person has repaid the amount of the tax to the ultimate purchaser of the article.

(3) *Ultimate purchaser*—(i) *General rule.* The term "ultimate purchaser", as used in paragraph (a)(2) of this section, means the person who purchased the article for consumption, or for use in the manufacture of other articles and not for resale in the form in which purchased.

(ii) *Special rule under section 6416(a)(3).* (A) *Conditions to be met.*—If tax under chapter 32 is paid in respect of an article and the Commissioner determines that the article is not subject to tax under chapter 32, the term "ultimate purchaser", as used in paragraph (a)(2) of this section, includes any wholesaler, jobber, distributor, or retailer who, on the 15th-day after the date of the determination, holds for sale any such article with respect to which tax has been paid, if the claim for credit or refund of the overpayment in respect of the articles held for sale by the wholesaler, jobber, distributor, or retailer is filed on or before the date on which the person who paid the tax is required to file a return for the period ending with the first calendar quarter which begins more than 60 days after the date of the determination by the Commissioner.

(B) *Supporting statement.*—A claim for credit or refund of an overpayment of tax in respect of an article as to which a wholesaler, jobber, distributor, or retailer is the ultimate purchaser, as provided in this paragraph (a)(3)(ii), must be supported by a statement that the person filing the claim has a statement, by each wholesaler, jobber, distributor, or retailer whose articles are covered by the claim, showing total inventory, by model number and quantity, of all such articles purchased tax-paid and held for sale as of 12:01 a.m. of the 15th day after the date of the determination by the Commissioner that the article is not subject to tax under chapter 32.

(C) *Inventory requirement.*—The inventory shall not include any such article title to which, or possession of which, has previously been transferred to any person for purposes of consumption unless the entire purchase price was repaid to the person or credited to the person's account and the sale was rescinded or any such article purchased by the wholesaler, jobber, distributor, or retailer as a component part of, or on or in connection with another article. An article in transit at the first moment of the 15th day after the date of the determination is regarded as being held by the person to whom it was shipped, except that if title to the article does not pass until delivered to the person the article is deemed to be held by the shipper.

(b) *Overpayments described in section 6416(b)(3)(C) or (4). (prior to April 1, 1983) and section 6416(b)(2)*—(1) *Claims included.*—This paragraph applies only to claims for credit or refund of amounts paid as tax under chapter 32 that are determined to be overpayments by reason of section 6416(b)(2) (relating to tax payments in respect of certain uses, sales, or resales of a taxable article), section 6416(b)(3)(C) (relating to tax-paid tires or inner tubes used for further manufacturer), or section 6416(b)(4) (relating to tires or inner tubes used by the manufacturer on another manufactured article).

(2) *Supporting evidence required.*—No credit or refund of an overpayment to which this paragraph (b) applies shall be allowed unless the person who paid the tax submits with the claim a statement, supported by sufficient available evidence, asserting that—

(i) The person neither included the tax in the price of the article with respect to which it was imposed nor collected the amount of the tax from a vendee, and identifying the nature of the evidence available to establish these facts, or

(ii) The person repaid, or agreed to repay, the amount of the tax to the ultimate vendor of the article, or

(iii) The person has secured, and will submit upon request of the Service, the written consent of the ultimate vendor to the allowance of the credit or refund.

(3) *Ultimate vendor.*—(i) *General rule.*—The term "ultimate vendor", as used in paragraph (b)(2) of this section, means the seller making the sale which gives rise to the overpayment or which last precedes the exportation or use which has given rise to the overpayment.

(ii) *Special rule under section 6416(a)(3)(B) prior to revision by the Highway Revenue Act of 1982.*—In the case of an overpayment determined under section 6416(b)(2)(F), (3)(C), or (4) in respect of tires or inner tubes, where the taxable article is used as a component part of, or sold on or in connection with or with the sale of, a second article which is exported, sold to a nonprofit educational organization for its exclusive use, sold to a State or local government for the exclusive use of a State or local government or used or sold for use as supplies for vessels or aircraft, the term "ultimate vendor", as used in paragraph (b)(2) of this section, means the ultimate vendor of the

second article. See §§48.6416(b)(2)-2(g), 48.6416(b)(3)-2(d), and 48.6416(b)(4)-1(b), respectively.

(c) *Overpayments not included.* This section does not apply to any overpayment determined under section 6416(b)(1) (relating to price readjustments), section 6416(b)(3)(A) (relating to certain cases in which refund or credits allowable to the manufacturer who uses, in the further manufacture of a second article, a taxable article purchased by the manufacturer tax-paid), section 6416(b)(3)(B) prior to April 1, 1983 (relating to parts or accessories taxable under section 4061(b) and used by a subsequent manufacturer or producer as material or a component part of any other article manufactured or produced by him), section 6416(b)(4) after march 31, 1983 (relating to tires), section 6416(b)(5) (relating to the return to the seller of certain installment accounts which the seller had previously sold) or section 6416(b)(6) (relating to truck chassis, bodies, and semi-trailers used for further manufacture). In this regard, see §§48.6416(b)(1)-1, 48.6416(b)(3)-1, and 48.6416(b)(5)-1.

Par. 23. Section 48.6416(b)-1 is removed, and the following new §§48.6416(b)(1)-1, 48.6416(b)(1)-2, 48.6416(b)(1)-3, and 48.6416(b)(1)-4 are added immediately after §48.6416(a)-3.

§48.6416(b)(1)-1 Price readjustments causing overpayments of manufacturers tax.

In the case of any payment of tax under chapter 32 that is determined to be an overpayment by reason of a price readjustment within the meaning of section 6416(b)(1) and §48.6416(b)(1)-2 or §48.6416(b)(1)-3, the person who paid the tax may file a claim for refund of the overpayment or may claim credit for the overpayment on any return of tax under this subpart which the person subsequently files. Price readjustments may not be anticipated. However, if the readjustment has actually been made before the return is filed for the period in which the sale was made, the tax to be reported in respect of the sale may, at the election of the taxpayer, be based either (a) on the price as so readjusted or (b) on the originals sale price and credit or refund claimed in respect of the price readjustment. A price readjustment will be deemed to have been made at the time when the amount of the readjustment has been refunded to the vendor or the vendor has been informed that the vendor's account has been credited with the amount. No interest shall be paid on any credit or refund allowed under this section. For provisions relating to the evidence required in support of a claim for credit or refund, see §301.6402-2 of this chapter (Regulations on Procedure and Administration), §48.6416(a)-3(a)(2), and §48.6416(b)(1)-4. For provisions authorizing the taking of a credit in lieu of filing a claim for refund, see section 6416(d) and §48.6416(f)-1.

§48.6416(b)(1)-2 Determination of price readjustments

(a) *In general.*—(1) *Rules of usual application.*—(i) *Amount treated as overpayment*—If the tax imposed by chapter 32 has been paid and thereafter the price of the article on which the tax was based is readjusted, that part of the tax which is proportionate to the part of the price which is repaid or credited to the purchaser is considered to be an overpayment. A readjustment of price to the purchaser may occur by reason of—

(A) The return of the article,

(B) The repossession of the article,

(C) The return or repossession of the covering or container of the article, or

(D) A bona fide discount, rebate, or allowance against the price at which the article was sold.

(ii) *Requirements of price readjustment.* A price readjustment will not be deemed to have been made unless the person who paid the tax either—

(A) Repays part or all of the purchase price in cash to the vendee,

(B) Credits the vendee's account for part or all of the purchase price, or

(C) directly or indirectly reimburses a third party for part or all of the purchase price for the direct benefit of the vendee.

In addition, to be deemed a price readjustment, the payment or credit must be contractually or economically related to the taxable sale that the payment or credit purports to adjust. Thus, commissions or bonuses paid to a manufacturer's own agents or salesperson for selling the manufacturer's taxable products are not price readjustments for purposes of this section, since those commissions or bonuses are not paid or credited either to the manufacturer's vendee or to a third party for the vendee's benefit. On the other hand, a bonus paid by the manufacturer to a dealer's salesperson for negotiating the sale of a taxable article previously sold to the dealer by the manufacturer is considered to be a readjustment of the price on the original sale of the taxable article, regardless of whether the payment to the salesperson is made directly by the manufacturer or to the salesperson through the dealer. In such a case, the payment is related to the sale of a taxable article and is made for the benefit of the dealer because it is made to the dealer's salesperson to encourage the sale of a product owned by the dealer. Similarly, payments or credits made by a manufacturer to a vendee as reimbursement of interest expense incurred by the vendee in connection with a so-called "free flooring" arrangement for the purchase of taxable articles is a price readjustment, regardless of whether the payment or credit is made directly to the vendee or to the vendee's creditor on behalf of the vendee.

(iii) *Limitation on credit or refu* The credit or refund allowable by reason of a price readjustment in respect of the sale of a taxable article may not exceed an amount which bears the same ratio to the total tax originally imposed and payable on the article as the amount of the tax-included readjustment bears to the original tax-included sale price of the article.

Example. A manufacturer sells a taxable article for $100 plus $10 excise tax, and reports and pays tax liability accordingly. Thereafter, the manufacturer credits the customer's account $11 (tax included) in readjustment of the original sale price. the overpayment of tax is $1, determined as follows:

$$\frac{\text{Tax-included readjustment}}{\text{Tax-included sale price}} \times \text{Original tax} = \text{Tax overpaid}$$

$$\frac{\$11}{\$110} \times \$10 = \$1 \text{ tax overpaid.}$$

(2) *Rules of special applicat* (i) *Constructive sale price.*—If, in case of a taxable sale, the tax imposed by chapter 32 is based on a constructive sale price determined under any paragraph of section 4216(b) and the regulations thereunder, as determined without reference to section 4218, the price readjustment made with re

the sale may be taken into account under this section only to the extent that the price readjustment reduces the actual sale price of the article below the constructive sale price.

Example. (A) A manufacturer sells a taxable article at retail for $110 tax included. Under section 4216(b)(1) the constructive sale price (tax included) of the article is determined to be $93. Thereafter, the manufacturer grants an allowance of $10 to the purchaser, which reduces the actual selling price (tax included) to $100. Since the readjustment price still exceeds the amounts of the constructive sale price, this readjustment is not recognized as a price readjustment under this section.

(B) Subsequently, the manufacturer extends to the purchaser an additional price allowance of $10, thereby reducing the actual sale price to $90. Since the actual sale price is now $3 less than the constructive sale price of $93, the manufacturer has overpaid by the amount of tax attributable to the $3. Assuming the tax rate involved is 10 percent, and the prices involved are tax-included, the overpayment of tax would be $0.27, determined as follows:

$$\frac{\text{percentage tax rate}}{\text{100 plus percentage tax rate}} \times \text{tax-included readjustment} = \text{tax overpayment}$$

$$\left(\frac{10}{110} \times \$3 = \$0.27\right).$$

(ii) *Price determined under section 4223(b)(2).*—If a manufacturer (within the meaning of section 4223(a)) to whom an article is sold or resold free of tax in accordance with the provisions of section 4221(a)(1) for use in further manufacture diverts the article to a taxable use or sells it in a taxable sale, and pursuant to the provisions of section 4223(b)(2) computes the tax liability in respect of the use of sale on the price for which the article was sold to the manufacturer or on the price at which the article was sold by the actual manufacturer, a reduction of the price on which the tax was based does not result in an overpayment within the meaning of section 6416(b)(1) or this section. Moreover, if a manufacturer purchases an article tax free and computes the tax in respect of a subsequent sale of the article pursuant to the provisions of section 4223(b)(2), an overpayment does not arise by reason of readjustment of the price for which the article was sold by the manufacturer except where the readjustment results from the return or repossession of the article by the manufacturer, and all of the purchase price is refunded by the manufacturer. See, however, paragraph (b)(4) of this section as to repurchased articles.

(b) *Return of an article.*—(1) *Price readjustment.*—If a taxable article is returned to the manufacturer who paid the tax imposed by chapter 32 on the sale of the article, a price readjustment giving rise to an overpayment results—

(i) If the article is returned before use, and all of the purchase price is repaid to the vendee or credited to the vendee's account, or

(ii) If the article is returned under an express or implied warranty as to quality or service, and all or a part of the purchase price is repaid to the vendee or credited to the vendee's account, or

(iii) If title is still in the seller, as, for example, in the case of certain installment sales contracts, and all or a part of the purchase price is repaid to the vendee or credited to the vendee's account.

(2) *Return of purchase price.*—For purposes of paragraph (b)(1) of this section, if all of the purchase price of an article has been returned to the vendee, except for an amount retained by the manufacturer pursuant to contract as reimbursement of expense incurred in connection with the sale (such as a handling or restocking charge), all of the purchase price is considered to have been returned to the vendee.

(3) *Taxability of subsequent sale or use.*—If, under any of the conditions described in paragraph (b)(1) of this section, an article is returned to the manufacturer who paid the tax and all of the purchase price is returned to the vendee, the sale is considered to have been rescinded. Any subsequent sale or use of the article by the manufacturer will be considered to be an original sale or use of the article by the manufacturer which is subject to tax under chapter 32 unless otherwise exempt. If under any such condition an article is returned to the manufacturer who paid the tax and only part of the purchase price is returned to the vendee, a subsequent sale of the article by the manufacturer will be subject to tax to the extent that the sale price exceeds the adjusted sale price of the first taxable sale.

(4) *Treatment of other transactions as repurchases.*—Except as provided in paragraph (b)(1) of this section, a price readjustment will not result when a taxable article is returned to the manufacturer who paid the tax on the sale of the article, even though all or a part of the purchase price is repaid to the vendee or credited to the vendee's account, since such a transaction will be considered to be a repurchase of the article by the manufacturer.

(c) *Repossession of an article.* If a taxable article is repossessed by the manufacturer who paid the tax imposed by chapter 32 on the sale of the article and all or a part of the purchase price is repaid to the vendee or credited to the vendee's account, a price readjustment giving rise to an overpayment will result. However, if the manufacturer later resells the repossessed article for a price in excess of the original adjusted sale price, the manufacturer will be liable for tax under chapter 32 to the extent that the resale price exceeds the original adjusted sale price.

(d) *Return or repossession of covering or container.* If the covering or container of a taxable article is returned to, or repossessed by the manufacturer who paid the tax imposed by chapter 32 on the sale of the article, and all or a portion of the purchase price is repaid to the vendee or credited to the vendee's account by reason of the return or repossession of the covering or container, a price adjustment giving rise to an overpayment will result. If a taxable article is considered to have been repurchased, as provided in paragraph (b)(4) of this section, and the covering or container accompanies the taxable article as part of the transaction, the covering or container will also be considered to have been repurchased.

(e) *bona fide discounts, rebates, or allowances*—(1) *In general.* Except as provided in §48.6416(b)(1)-3 (relating to readjustments in respect of local advertising), the basic consideration in determining, for purposes of this section, whether a bona fide discount, rebate, or allowance has been made is whether the price actually paid by, or charged against, the purchaser has in fact been reduced by subsequent transactions between the parties. Generally, the price will be considered to have been readjusted by reason of a bona fide discount, rebate, or allowance, only if the manufacturer who made the taxable sale repays a part of the purchase price in cash to the vendee, or credits the vendee's account, or directly

or indirectly reimburses a third party for part of all of the purchase price for the direct benefit of the vendee, in consideration of factors which, if taken into account at the time of the original transaction, would have resulted at that time in a lower sale price. For example, a price readjustment will be considered to have been made when a bona fide discount, rebate, or allowance is given in consideration of such factors as prompt payment, quantity buying over a specified period, the vendee's inventory of an article when new models are introduced, or a general price reduction affecting articles held in stock by the vendee as of a certain date. On the other hand, repayments made to the vendee do not effectuate price readjustments if given in consideration of circumstances under which the vendee has incurred, or is required to incur, an expense which, if treated as a separate item in the original transaction, would have been includible in the price of the article for purposes of computing the tax.

Examples. The provisions of paragraph (e)(1) of this section may be illustrated by the following examples:

Example (1). B, a manufacturer of fishing rods, bills its distributors in a specified amount per fishing rods purchased by them. Thereafter, B issues to each distributor a credit memorandum in the amount of X dollars for each demonstration by the distributor of the fishing rods at a sporting goods exhibition. The credit which B allows the distributor for demonstration of B's product does not effect a readjustment of price.

Example (2). C, a manufacturer of automobiles, bills its dealers in a specified amount per automobile purchased by them. Thereafter, C remits to the dealer X dollars of the original sale price for each automobile sold by the dealer in the last month of the model year. An additional amount of Y dollars is paid to the dealer upon a showing by the dealer that the dealer has paid Y dollars to the sales person who made the sale. In this case, the X dollars paid to the dealer by C constitutes a bona fide discount, rebate, or allowance since payment of such amount is in the nature of a price reduction by reason of the dealer's inventory when new models are introduced. In addition, the Y dollars paid to the dealer in reimbursement for the amount paid by the dealer to the salesperson who made the sale, also constitutes a bona fide discount, rebate, or allowance.

(2) *Inability to collect price.* A charge-off of an amount outstanding in an open account, due to inability to to collect, is not a bona fide discount, rebate, or allowance and does not, in and of itself, give rise to a price readjustment within the meaning of this section.

(3) *Loss or damage in transit.* If title to an article has passed to the vendee, the subsequent loss, damage, or destruction of the article while in the possession of a carrier for delivery to the vendee does not, in and of itself, affect the price at which the article was sold. However, if the article was sold under a contract providing that if the article was lost, damaged, or destroyed in transit, title would revert to the vendor and the vendor would reimburse the vendee in full for the sale price, then the original sale is considered to have been rescinded. The vender is entitled to credit or refund of the tax paid upon reimbursement of the full tax-included sale price to the vendee.

§48.6416(b)(1)-3 Readjustment for local advertising charges.

(a) *In general.* If a manufacturer has paid the tax imposed by chapter 32 on the price of any article sold by the manufacturer and thereafter has repaid a portion of the price to the purchaser or any subsequent vendee in reimbursement of expenses for local advertising of the article or any other article sold by the manufacturer which is taxable at the same rate under the same section of chapter 32, the reimbursement will be considered a price readjustment constituting an overpayment which the manufacturer may claim as a credit or refund. The amount of the reimbursement may not, however, exceed the limitation provided by section 4216(e)(2) and §48.4216(e)-2, determined as of the close of the calendar quarter in which the reimbursement is made or as of the close of any subsequent calendar quarter of the same calendar year in which it is made. The term "local advertising", as used in this section, has the same meaning as prescribed by section 4216(e)(4) and includes generally, advertising which is broadcast over a radio station or television station, or appears in a newspaper or magazine, or is displayed by means of an outdoor advertising sign or poster.

(b) *Local advertising charges excluded from taxable price in one year but repaid in following year*—(1) *Determination of price readjustments for year in which charge is repaid.* If the tax imposed by chapter 32 was paid with respect to local advertising charges that were excluded in computing the taxable price of an article so in any calendar year but are not repa to the manufacturer's purchaser or a subsequent vendee before May 1 of t following calendar year, the subseque repayment of those charges by the ma ufacturer in reimbursement of expens for local advertising will be consider a price readjustment constituting overpayment which the manufactur may claim as a credit or refund. T amount of the reimbursement may n however, exceed the limitation pr vided by section 4216(e)(2) a §48.4216(e)-(2), determined as of t close of the calendar quarter in whi the reimbursement is made or as of t close of any subsequent calendar qua ter of the same calendar year in whi it is made.

(2) *Redetermination of price rea justments for year in which charge w made.* If the tax imposed by chapter was paid with respect to local adverti ing charges that were excluded computing the taxable price of an ar cle sold in any calendar year but a not repaid to the manufacturer's pu chaser or any subsequent vendor bef May 1 of the following calendar ye the manufacturer may make redetermination, in respect of the cale dar year in which the charge was mad of the price readjustments constituti an overpayment which the manufa turer may claim as a credit or refun This redetermination may be made excluding the local advertising charg made in the calendar year that becan taxable as of May 1 of the followi calendar year.

§48.6416(b)(1)-4 Supporting eviden required in case of price readju ments.

No credit or refund of an overpa ment arising by reason of a price rea justment described in §48.6416(b)(1) or §48.6416(b)(1)-3 shall be allow unless the manufacturer who paid t tax submits a statement, supported sufficient available evidence—

(a) Describing the circumstanc which gave rise to the price readju ment.

(b) Identifying the article in resp of which the price readjustment w allowed.

(c) Showing the price at which t article was sold, the amount of tax p in respect of the article, and the date

which the tax was paid.

(d) Giving the name and address of the purchaser to whom the article was sold, and

(e) Showing the amount repaid to the purchaser or credited to the purchaser's account.

Par. 24. Section 48.6416(b)-2 is removed and the following new §§48.6416(b)(2)-1, 48.6416(b)(2)-2, 48.6416(b)(2)-3 and 48.6416(b)(2)-4 are added immediately after §48.6416(b)(1)-4.

§48.6416(b)(2)-1 Certain exportations, uses, sales, or resales causing overpayments of tax.

In the case of any payment of tax under section 4041(a)(1) or (a)(2) (diesel fuel and special fuels tax) or under chapter 32 (Manufacturers tax) that is determined to be an overpayment by reason of certain exportations, uses, sales, or resales described in section 6416(b)(2) and §48.6416(b)(2)-2, the person who paid the tax may file a claim for refund of the overpayment or, in the case of overpayments under chapter 32, may claim credit for the overpayment on any return of tax under this subpart which the person subsequently files. However, under the circumstances described in section 6416(c) and §48.6416(e)-1, the overpayments under chapter 32 may be refunded to an exporter or shipper. In the case of overpayments of tax under section 4041 resulting from certain nontaxable uses of tax-paid fuel after June 30, 1970, see also section 6427 and the regulations thereunder. No interest shall be paid on any credit or refund allowed under this section. For provisions relating to the evidence required in support of a claim for credit or refund under this section, see §301.6402-2 of this chapter (Regulations on Procedure and Administration) and §§48.6416(b)(2)-3 and 48.6416(b)(2)-4. For provisions authorizing the taking of a credit in lieu of filing a claim for refund, see section 6416(d) and §48.6416(f)-1.

§48.6416(b)(2)-2 Exportations, uses, sales, and resales included.

(a) *In general.* The payment of tax imposed by section 4041(a)(1) or (a)(2), or by chapter 32, as the case may be, on the sale of any article, other than coal taxable under section 4121, will be considered to be an overpayment by reason of any exportation, use sale, or resale described in any one of paragraphs (b) to (o), inclusive, of this section. This section applies only in those cases where the exportation, use, sale, or resale (or any combination thereof) referred to in any one or more of these paragraphs occurs before any other use. If any article is sold or resold for a use described in any one of these paragraphs and is not in fact so used, the paragraph is treated in all respects as inapplicable.

(b) *Exportation of tax-paid articles.* Subject to the limitation in section 6416(g) and §48.6416(g)-1 (applying to articles subject to the tax imposed by section 4061(a) prior to April 1, 1983), a payment of tax under chapter 32 on the sale of any article, or under section 4041(a)(1) or (a)(2) on the sale of diesel fuel or special motor fuel, will be considered to be an overpayment under section 6416(b)(2)(A) if the article or fuel is by any person exported to a foreign country or shipped to a possession of the United States. Except in the case of articles subject to the tax imposed by section 4061(a) prior to April 1, 1983, it is immaterial for purposes of this paragraph (b), whether the person who made the taxable sale had knowledge at the time of the sale that the article or fuel was being purchased for export to a foreign country or shipment to a possession of the United States. See §48.6316(e)-1 for the circumstances under which a claim for refund by reason of the exportation of an article may be claimed by the exporter or shipper, rather than by the person who paid the tax. For definition of the term "possession of the United States", see §48.0-2(a)(11).

(c) *Supplies for vessels or aircraft.* A payment of tax under chapter 32 on the sale of any article, or under section 4041(a)(1) or (a)(2) on the sale of diesel fuel or special motor fuel, will be considered to be an overpayment under section 6416(b)(2)(B) if the article or fuel is used by any person, or is sold by any person for use by the purchaser, as supplies for vessels or aircraft.

The term "supplies for vessels or aircraft", as used in this paragraph, has the same meaning as when used in sections 4041(g), 4221(a)(3), 4221(d)(3),and 4221(e)(1), and the regulations thereunder.

(d) *Use by State or local government.* A payment of tax under chapter 32 on the sale of any article, or under section 4041(a)(1) or (a)(2) on the sale of diesel fuel or special motor fuel, will be considered to be an overpayment under section 6416(b)(2)(C) if the article of fuel is sold by any person to a State, any political subdivision thereof, or the District of Columbia for the exclusive use of a State, any political subdivision thereof, or the District of Columbia. For provisions relating to tax-free sales to a State, any political subdivision thereof, or the District of Columbia, see section 4221(a)(4) and the regulations thereunder.

(e) *Use by nonprofit educational organization.* A payment of tax under chapter 32 on the sale of any article, or under section 4041(a)(1) or (a)(2) on the sale of diesel fuel or special motor fuel, will be considered to be an overpayment under section 6416(b)(2)(D) if the article or fuel is sold by any person to a nonprofit educational organization for its exclusive use. The term "nonprofit educational organization", as used in this paragraph (e), has the same meaning as when used in section 4221(a)(5) or (d)(5), whichever applies, and the regulations thereunder.

(f) *Tax-paid tires or inner tubes resold for use in further manufacturer.* A payment of tax under section 4071 on the sale of a tire or, prior to January 1, 1984, on the sale of an inner tube will be considered to be an overpayment under section 6416(b)(2)(E) if—

(1) The tire or inner tube is, after the original sale of the article by the manufacturer, resold by any person to another manufacturer,

(2) The other manufacturer sells the tire or inner tube on or in connection with, or with the sale of, any other article manufactured or produced by the other manufacturer, and

(3) That other article is by any person either—

(i) Exported to a foreign country or to a possession of the United States,

(ii) Sold to a State, any political subdivision thereof, or the District of Columbia for the exclusive use of a State, any political subdivision thereof, or the District of Columbia,

(iii) Sold to a nonprofit educational organization for its exclusive use, or

(iv) Used or sold for use as supplies for vessels or aircraft.

The overpayment described in this paragraph (f) is to be distinguished from the overpayment described in section 6416(b)(3)(C) prior to amendment by the Highway Revenue Act of 1982 and section 6416(b)(3) as amended by the Highway Revenue Act of 1982, and §48.6416(b)(3)-2(d) in that the overpayment here described arises from a "resale" for the use described in this paragraph, while the section 6416-(b)(3)(C) overpayment arises from the "use" of tires or inner tubes in the manufacture of other articles by a subsequent manufacturer who purchases tax-paid tires or tubes and disposes of finished articles on the basis of one of the exemptions set forth in section 6416(B)(3)(C). A manufacturer claiming a credit or refund under this paragraph (f) must have substantially the same information available in support of the claim as is required under §48.4221-7(c)(2) in support of exempt sales of tires or inner tubes under the provisions of section 4221(e)(2), except that none of the parties involved need be registered under section 4222.

(g) *Parts of accessories used on farm equipment.* A payment of tax under section 4061(b) prior to January 7,1983, on the sale of parts or accessories (other than spark plugs and storage batteries) will be considered to be an overpayment under section 6416-(b)(2)(F) if the parts or accessories are used by any person, or are sold by any person for use by the purchaser, as repair parts, replacement parts or accessories for farm equipment. The term "farm equipment," as used in this paragraph (g), does not include any article taxable under section 4061(a)(1) (relating to trucks, buses, tractors, etc.). The term "parts or accessories," as used in this paragraph (g), has the same meaning as in section 4061(b) and the regulations thereunder. This paragraph (g) does not apply to an overpayment of tax arising by reason of section 6416(b)(3) and §48.6416(b)-(3)-1, relating to articles purchased tax paid from a manufacturer by a subsequent manufacturer and used by the subsequent manufacturer in further manufacture of a taxable or nontaxable article.

(h) *Tread rubber used for certain purposes.* All references in this paragraph to sections 4071(a)(4), 6416(b)(2)(G) and 4072 and the regulations thereunder, are to the Internal Revenue Code prior to its revision by the Highway Revenue Act of 1982. A payment of tax under section 4071(a)(4) prior to January 1, 1984, on the sale of tread rubber which is used by any person, or which is sold by any person for use by the purchaser, otherwise than in the recapping or retreading or tires of the type used on highway vehicles, will be considered to be an overpayment under section 6416-(b)(2)(G). If the tread rubber is used in the recapping or retreading of tires, the type of vehicle on which the recapped or retreaded tire is be used and the actual or intended use of the recapped or retreaded tire are immaterial in determining whether an overpayment arises under this paragraph (h). The controlling factor is whether the tire resulting form the recapping or retreading is of a type which is not used on a highway vehicle. The term "tread rubber," "tires of the type used on highway vehicles", and "tires", as used in this paragraph (h) have the same meaning as in section 4072 and the regulations thereunder. This paragraph (h) does not apply to an overpayment arising by reason of section 6416(b)(3) and §48.6416(b)(3)-1, relating to articles purchased tax paid from a manufacturer by a subsequent manufacturer and used by the subsequent manufacturer in further manufacture of another article taxable under chapter 32.

(i) *Gasoline used in production of special fuels.* A payment of tax under section 4081 on the sale of gasoline will be considered to be an overpayment under section 6416(b)(2)(H) (section 6416(b)(2)(F) after March 31, 1983) if the gasoline is used by any person, or sold by any person for use by the purchaser, in the production of a special fuel. The term "special fuel", as used in this paragraph (i), has the same meaning as in section 4041 and the regulations thereunder.

(j) *Articles sold for use as trash containers.* All references in this paragraph are to the Internal Revenue Code of 1954 prior to its revision by the Highway Revenue Act of 1954. See section 4053(6) of the Internal Revenue Code of 1954 as amended by the Highway Revenue Act of 1982 for provisions relating to articles designed to be used as trash containers. A payment of tax under section 4061(a) on a sale prior to April 1, 1983, of any box, container, receptacle, bin, or other similar article will be considered to be an overpayment under section 6416(b)(2)(J) if the article is—

(1) Sold by any person to any purchaser for use by the purchaser as a trash container,

(2) Not designed for the transportation of freight other than trash, and

(3) Not designed to be permanently mounted on, or permanently affixed to, a chassis or body of an automobile truck, truck trailer, or truck semitrailer.

In addition, a payment of tax under section 4061(b) on parts or accessories for any such box, container, receptacle, etc., will be considered to be an overpayment under section 6416(b)(2)(J) if the part or accessory is designed primarily for use on, in connection with, or as a component part of, the box, container, receptacle, etc., and is installed on the box, container, receptacle, etc. at the time of sale or is sold with the article as an integral part of the container system. This paragraph (j) does not apply to parts or accessories sold for use as replacement parts or accessories, even if those parts or accessories are sold in connection with the sale of a box, container, receptacle, etc. Any term used in this paragraph (j) that is also used in section 4063(a)(7) or the regulations thereunder has the same meaning as in that section and the regulations thereunder.

(k) *Parts or accessories sold in connection with light-duty trucks.* All references in this paragraph are to the Internal Revenue Code of 1954 prior to its revision by the Highway Revenue Act of 1982. A payment of tax under section 4061(b) on the sale of parts or accessories will be considered to be an overpayment under section 6416-(b)(2)(K) if—

(1) The parts or accessories are sold on or in connection with the first retail sale of a light-duty truck as described in section 4061(a)(2) and the regulations thereunder, and

(2) The credit or refund of tax is not available under any other provisions of law.

The term "parts or accessories," as

used in this paragraph (k), has the same meaning as in section 4061(b) and the regulations thereunder. This paragraph (k) does not apply to an overpayment of tax arising by reason of section 6416(b)(2) and §48.6416(b)(3)-1, relating to articles purchased tax-paid from a manufacturer by a subsequent manufacturer and used by the subsequent manufacturer in further manufacture of a taxable or nontaxable article.

§48.6416(b)(2)-3 Supporting evidence required in case of manufacturers tax involving exportations, uses, sales, or resales.

(a) *Evidence to be submitted by claimant.* No claim for credit or refund of an overpayment, within the meaning of section 6416(b)(2) and §48.6416-(b)(2)-2, of tax under chapter 32 shall be allowed unless the person who paid the tax submits with the claim the evidence required by paragraph (b)(2) of §48.6416(a)-3 and a statement, supported by sufficient available evidence—

(1) Showing the amount claimed in respect of each category of exportations, uses, sales, or resales on which the claim is based and which give rise to a right of credit or refund under section 6416(b)(2) and §48.6416(b)(2)-1,

(2) Identifying the article, both as to nature and quantity, in respect of which credit or refund is claimed,

(3) Showing the amount of tax paid in respect of the article or articles and the dates of payment, and

(4) In the case of an overpayment determined under section 6416(b)(2)(A) and paragraph (b) of §48.6416(b)(2)-2 in respect of an article which was taxable prior to April 1, 1983, under section 4061(a), indicating that, pursuant to section 6416(g), the person claiming a credit or refund possessed at the time that person shipped the article or at the time title to the article passed to the vendee, whichever is earlier, evidence that the article was to be exported to a foreign country or shipped to a possession of the United States, or

(5) In the case of any overpayment other than an overpayment determined under section 6416(b)(2)(E) and paragraph (f) of §48.6416(b)(2)-2, indicating that the person claiming a credit or refund possesses evidence (as set forth in paragraph (b)(1) of this section) that the article has been exported, or has been used, sold, or resold in a manner or for a purpose which gives rise to an overpayment within the meaning of section 6416(b)(2) and §48.6416-(b)(2)-2, or

(6) In the case of an overpayment determined under section 6416(b)(2)(E) and paragraph (f) of §48.6416(b)(2)-2, relating to a tax-paid tire or inner tube sold on or in connection with, or with the sale of, a second article that has been manufactured, indicating that the person claiming credit or refund possesses (i) evidence (as set forth in paragraph (b)(2) of this section) that the second article has been exported, or has been used or sold as provided in §48.6416(b)(2)-2(f), and (ii) a statement, executed and signed by the ultimate purchaser of the tire or inner tube, that the ultimate purchaser purchased the tire or inner tube from a person other than the person who paid the tax on the sale of the tire or inner tube.

(b) *Evidence required to be in possession of claimant*—(1) *Evidence required under paragraph (a)(5)*—(i) *In general.* The evidence required to be retained by the person who paid the tax, as provided in paragraph (a)(5) of this section, must, in the case of an article exported, consist of proof of exportation in the form prescribed in the regulations under section 4221 or must, in the case of other articles sold tax-paid by that person, consist of a certificate, executed and signed by the ultimate purchaser of the article, in the form prescribed in paragraph (b)(1)(ii) of this section. However, if the article to which the claim relates has passed through a chain of sales form the person who paid the tax to the ultimate purchaser, the evidence required to be retained by the person who paid the tax may consist of a certificate, executed and signed by the ultimate vendor of the article, in the form provided in paragraph (b)(1)(iii) of this section, rather than the proof of exportation itself or the certificate of the ultimate purchaser.

(ii) *Certificate of ultimate purchaser.*

(A) The certificate executed and signed by the ultimate purchaser of the article to which the claim relates must identify the article, both as to nature and quantity; show the address of the ultimate purchaser of the article, and the name and address of the ultimate vendor of the article; and describe the use actually made of the article in sufficient detail to establish that credit or refund is due, except that the use to be made of the article must be described in lieu of actual use if the claim is made by reason of the sale or resale of an article for a specified use which gives rise to the overpayment.

(B) If the certificate sets forth the use to be made of any article, rather than its actual use, it must show that the ultimate purchaser has agreed to notify the claimant if the article is not in fact used as specified in the certificate.

(C) The certificate must also contain a statement that the ultimate purchaser understands that the ultimate purchaser and any other party may, for fraudulent use of the certificate, be subject under section 7201 to a fine or not more than $10,000, or imprisonment for not more than 5 years, or both, together with the costs of prosecution.

(D) A purchase order will be acceptable in lieu of a separate certificate of the ultimate purchaser if it contains all the information required by this paragraph (b)(1)(ii).

(iii) *Certificate of ultimate vendor.* Any certificate executed and signed by an ultimate vendor as evidence to be retained by the person who paid the tax, as provided in paragraph (a)(5) of this section, may be executed with respect to any one or more overpayments by the person which arose under section 6416(b)(2) and §§48.6416(b)(2)-2 by reason of exportations, uses, sales or resales, occurring within any period of not more than 12 consecutive calendar quarters, the beginning and ending dates of which are specified in the certificate.

The certificate must be in substantially the following form:

Statement of Ultimate Vendor

(For use in claiming credit or refund of overpayment determined under section 6416(b)(2) (other than section 6416(b)(2)(E) of the Internal Revenue Code.)

The undersigned or the

_____

(Name of ultimate vendor if other than undersigned) of which the undersigned is (Title), is the ultimate vendor of the article specified below or on the reverse side hereof.

The article was purchased by the ultimate vendor tax-paid and was thereafter exported, used, sold, or resold (as indicated below or on the reverse side hereof).

The ultimate vendor possesses

_____

(Proof of exportation in respect of the article, or a

certificate as to use executed by the ultimate purchaser of the article)
The _____
(Proof of exportation or certificate)
(1) is retained by the ultimate vendor, (2) will, upon request, be forwarded to
_____
(Name or person who paid the tax)
at any time within 3 years from the date of this statement for use by that person to establish that credit or refund is due in respect of the article, and (3) will otherwise be held by the ultimate vendor for the required 3-year period.

According to the best knowledge and belief of the undersigned, no statement in respect of the
_____
(Proof of exportation or certificate)
has previously been executed, and the undersigned understands that the fraudulent use of this statement may, under section 7201, subject the undersigned or any other party making such fraudulent use to a fine of not more than $10,000, or imprisonment for not more than 5 years, or both, together with the costs of prosecution.

_____
(Signature)

_____
(Address)

_____
(Date)

Vendor's invoice	Articles	Date of resale	Quantity	Exported or use made or to be made (specify)

(2) *Evidence required under paragraph (a)(6).*—(i) *In general.*—The evidence required to be retained by the person who paid the tax, as provided in paragraph (a)(6) of this section, must, in the case of an exportation of the second article, consist of proof of exportation of the second article in the form prescribed in the regulations under section 4221 or must, in other cases, consist of a certificate, executed and signed by the ultimate purchaser of the second article, in the form prescribed in paragraph (b)(2)(ii) of this section. However, the evidence required to be retained by the person who paid the tax may consist of a certificate, executed and signed by the ultimate vendor of the second article, in the form provided in paragraph (b)(2)(iii) of this section, rather than the proof of exportation itself or the certificate of the ultimate purchaser.

(ii) *Certificate of ultimate purchaser.*—The certificate of the ultimate purchaser of the second article must contain the same information as that required in paragraph (b)(1)(ii) of this section, except that the information must be furnished in respect of the second article, rather than the article to which the claims relates.

(iii) *Certificate of ultimate vendor.*—Any certificate executed and signed by an ultimate vendor as evidence to be retained by the person who paid the tax, as provided in paragraph (a)(6) of this section, may be executed with respect to any one of more overpayments by that person which arose under section 6416(b)(2)(E) and §48.6416(b)(2)-2(f) by reason of exportations, uses, sales, or resales of a second article occurring within any period of not more than 12 consecutive calendar quarters, the beginning and ending dates of which are specified in the certificate. The certificate must be in substantially the following form:

STATEMENT OF ULTIMATE VENDOR

(For use in claiming credit or refund of overpayment determined under section 6416(b)(2)(E) Internal Revenue Code involving tires or inner tubes sold on or with another article)
The undersigned or the
_____
(Name of ultimate vendor of second article if other than undersigned)
of which the undersigned is (Title), is the ultimate vendor of an article, specified below or on the reverse side hereof, on which or with which a tax-paid tire or inner tube was sold.
The ultimate vendor possesses
_____
(Proof of exportation in respect of the article on which or with which the tire or inner tube was sold, or a certificate as to use of the article executed by the ultimate purchaser of the article)
The
_____
(Proof of exportation or certificate) (1) is retained by the ultimate vendor, (2) will, upon request, be forwarded to
_____
(Name of person who paid the tax on the tire or inner tube)
at any time within 3 years from the date of this statement for use in establishing that credit or refund is due in respect of the tire or inner tube, and (3) will otherwise be held by the ultimate vendor for the required 3-year period.

According to the best knowledge and belief of the undersigned, no statement in respect of the
_____
(Proof of exportation or certificate)
has previously been executed, and the undersigned understands that the fraudulent use of this statement may, under section 7201, subject the undersigned or any other party making such fraudulent use to a fine of not more than $10,000, or imprisonment for not more than 5 years, or both, together with the costs of prosecution.

_____
(Signature)

_____
(Address)

_____
(Date)

Tires or Inner tubes (specify and state quantity)	Vendor's Invoice on second article	Second article (specify and state quantity)	Date of sale of second article	Exported or use made of or to be made (specify in respect of second article)

(3) *Repayment or consent of ultimate vendor.* If the person claiming credit or refund of an overpayment to which this section applies has repaid, or agreed to repay, the amount of the overpayment to the ultimate vendor or if the ultimate vendor consents to the allowance of the credit or refund, a statement to that effect, signed by the ultimate vendor, must be shown on, or made a part of, the evidence required under this section to be retained by the person claiming the credit or refund. In this regard, see §48.6416(a)-3(b)(2).

§48.6416(b)(2)-4 Supporting evidence required in case of special fuel tax involving exportations, uses, sales, or resales of special fuels.

(a) *Evidence to be submitted by claimant.* No claim for credit or refund of an overpayment, within the meaning of section 6416(b)(2) and §48.6416(b)(2)-2 of tax under section 4041(a)(1) or (a)(2) shall be allowed unless the person who paid the tax submits with the claim the evidence required by paragraph (b)(2) of §48.6416(a)-2 and a statement, supported by sufficient available evidence—

(1) Showing the amount claimed in respect of each category of exportations, uses, sales, or resales on which the claim is based and which give rise to right of credit or refund under section 6416(b)(2) and §48.6416(b)(2)-1,

(2) Identifying the fuel, both as to nature and quantity, in respect of which credit or refund is claimed,

(3) Showing the amount of tax paid

in respect of the fuel and the dates of payment, and

(4) Indicating that the fuel has been exported, or has been used, sold, or resold in a manner or for a purpose which gives rise to an overpayment within the meaning of section 6416(b)(2) and §48.6416(b)(2)-2.

(b) *Evidence required to be in possession of claimant.* (1) The evidence required to be retained by the person who paid the tax, as provided in paragraph (a)(4) of this section, must, in the case of fuel exported, consist of proof of exportation or must, in the case of other fuel sold tax-paid by that person, consist of a certificate, executed and signed by the person who purchased the fuel in a resale or for the use which gave rise to the overpayment.

(2) The certificate must identify the fuel, both as to nature and quantity, in respect of which credit or refund is claimed; show the address of the purchaser, show the name and address of the person from whom the fuel was purchased and the date or dates on which the fuel was purchased; and show that the fuel was purchased; and show that the fuel was resold and the date of the resale.

(3) If the claim is not based on resale of the fuel, the certificate must describe the use actually made of the fuel in sufficient detail to establish that credit or refund is due. However, the use to be made of the fuel must be described in lieu of actual use if the claim is made by reason of the sale of the fuel for a specified use which gives rise to an overpayment under §48.6416(b)(2)-2.

(4) If the certificate sets forth the use to be made of the fuel, rather than its actual use, it must show that the purchaser has agreed to notify the claimant if the fuel is not in fact used as specified in the certificate.

(5) The certificate must also contain a statement that the purchaser has not previously executed a certificate in respect of the fuel and understands that any part may, for fraudulent use of the certificate, be subject under section 7201 to a fine of not more than $10,000, or imprisonment for not more than 5 years, or both, together with the costs of prosecution.

Par. 25. Section 48.6416(b)-3 is removed and the following new §§48.6416(b)(3)-1, 48.6416(b)(3)-2, and 48.6416(b)(3)-3 are added immediately after 48.6416(b)(2)-4.

§48.6416(b)(3)-1 Tax-paid articles used for further manufacture and causing overpayments of tax.

In the case of any payment of tax under chapter 32 that is determined to be an overpayment under section 6416(b)(3) and §48.6416(b)(3)-2 by reason of the sale of an article (other than coal taxable under section 4121), directly or indirectly, by the manufacturer of the article to a subsequent manufacturer who uses the article in further manufacture of a second article or who sells the article with, or as a part of, the second article manufactured or produced by the subsequent manufacturer, the subsequent manufacturer may file claim for refund of the overpayment or may claim credit for the overpayment on any return of tax under this subpart subsequently filed. No interest shall be paid on any credit or refund allowed under this section. For provisions relating to the evidence required in support of a claim for credit or refund, see §301.6402-2 of this chapter (Regulations on Procedure and Administration) and §§48.6416(a)-3 and 48.6416(b)(3)-3. For provisions authorizing the taking of a credit in lieu of filing a claim for refund, see section 6416(d) and §48.6416(f)-1.

§48.6416(b)(3)-2 Further manufacture included.

(a) *In general.* The payment of tax imposed by chapter 32 on the sale of any article (other than coal taxable under section 4121) by a manufacturer of the article will be considered to be an overpayment by reason of any use in further manufacture, or sale as part of a second manufactured article, described in any one of paragraphs (b) through (f) of this section. This section applies in those cases where the exportation, use, or sale (or any combination of those activities) referred to in any one or more of those paragraphs occurs before any other use. For provisions relating to overpayments arising by reason of resales of tax-paid articles for use in further manufacture as provided in this section, see section 6416(b)(2)(E) and paragraph (f) of §48.6416(b)(2)-2.

(b) *Use of tax-paid articles in further manufacture described in section 6416(b)(3)(A).* A payment of tax under chapter 32 on the sale of any article (other than coal taxable under section 4121), directly or indirectly, by the manufacturer of the article to a subsequent manufacturer will be considered to be an overpayment under section 6416(b)(3)(A) if the article is used by the subsequent manufacturer as material in the manufacture or production of, or as a component part of, a second article manufactured or produced by the subsequent manufacturer which is—

(1) Taxable under chapter 32, or

(2) An automobile bus chassis or an automobile bus body.

For this purpose it is immaterial whether the second article is sold or otherwise disposed of, or if sold, whether the sale is a taxable sale. Any article to which this paragraph (b) applies which would have been used in the manufacture or production of a second article, except for the production of a second article, except for the fact that it was broken or rendered useless in the process of manufacturing or producing the second article, will be considered to have been used as a component part of the second article. This paragraph (b) does not apply to articles sold and used as provided in any of paragraphs (c) through (f) of this section.

(c) *Use of truck, bus, etc., parts or accessories.* A payment of tax under section 4061(b) on the sale prior to January 7, 1983, of any truck bus, etc., part or accessory, directly or indirectly, by the manufacturer of the article to a subsequent manufacturer will be considered to be an overpayment under section 6416(b)(3)(B) if the part or accessory is used by the subsequent manufacturer as material in the manufacture or production of or as a component part of, a second article manufactured or produced by the subsequent manufacturer. For this purpose it is immaterial whether the second article is or is not taxable under chapter 32. Any article to which this paragraph (c) applies which would have been used in the manufacture or production of a second article, except for the fact that it was broken or rendered useless in the process of manufacturing or producing the second article, will be considered to have been used as a component part of the second article.

(d) *Tax-paid tires or inner tubes used in further manufacture.* (1) A payment of tax under section 4071 on the sale prior to January 1, 1984, of a tire or inner tube, directly or indirectly, by the manufacturer of the article to a subsequent manufacturer will be considered to be an overpayment under section 6416(b)(3)(C) if the subsequent manufacturer sells the tire or inner tube on or in connection with, or with the sale of, any other article manufactured or produced by the subsequent manufacturer and if the other article is

(i) An automobile bus chassis or automobile bus body, or

(ii) By any person (A) exported to a foreign country or to a possession of the United States, (B) sold to a State, any political subdivision thereof, or the District of Columbia for the exclusive use of a State, any political subdivision thereof, or the District of Columbia, (C) sold to a nonprofit educational organization for its exclusive use, or (D) used or sold for use as supplies to vessels or aircraft. For tax-paid tires used in further manufacture after December 31, 1983, see section 6416(b)(3)(A) and the regulations thereunder.

(2) The overpayment in this paragraph (d) is to be distinguished from that overpayment described in section 6416(b)(2)(E) and §48.6416(b)(2)-2(f) in that this overpayment arises from the "use" described in this paragraph, whereas the overpayment under section 6416(b)(2)(E) arises from the "resale" of tax-paid tires or inner tubes by any person to a subsequent manufacturer who disposes of the articles on or in connection with, or with the sale of, a second article manufactured or produced by the subsequent manufacturer which is disposed of on the basis of one of the exemptions set forth in section 6416(b)(3)(C).

(3) If the second article is exported or shipped as provided in this paragraph (d), it is immaterial whether the subsequent manufacturer sold the article with the knowledge that it would be exported or shipped.

(4) An overpayment arises under paragraph (d)(1) of this section only if the tire or inner tube constitutes a part of, or is associated with, the second article at the time the second article is exported, shipped, sold, used, or sold for use, as prescribed in this paragraph.

(5) For definition of certain terms used in this paragraph, see section 4221 and the regulations thereunder.

(6) For provisions relating to overpayments arising by reason of tires or inner tubes sold tax-paid by the manufacturer of the same, on or in connection with, or with the sale of any article manufactured or produced by that manufacturer and exported, sold, or used or sold for use, as provided in this paragraph (d), see section 6416(b)(4) and §48.6416(b)(4)-1.

(7) For provisions relating to credit allowable in respect of tires and inner tubes sold on or in connection with, or with the sale of, another article taxable under chapter 32, prior to January 1, 1984, see section 6416(c) and §48.6416(c)-1.

(8) If a second article referred to in paragraph (d)(1) of this section is sold for a use described in that paragraph and is not so used, this paragraph (d) is in all respects inapplicable.

(e) *Use of bicycle tires or tubes in further manufacture.* A payment of tax under section 4071 on the sale, prior to January 1, 1984, of a bicycle or tricycle tire or inner tube, directly or indirectly, by the manufacturer of the same to a subsequent manufacturer will be considered to be an overpayment under section 6416(b)(3)(E) if the tire or tube is used by the subsequent manufacturer as material in the manufacture or production of, or as a component part of, a bicycle or tricycle manufactured or produced by the subsequent manufacturer which is not a rebuilt or reconditioned bicycle or tricycle. For definition of the term "bicycle tire", see section 4221(e)(4)(B) and the regulations thereunder.

(f) *Use of gasoline in further manufacture.* A payment of tax under section 4081 on the sale of gasoline, directly or indirectly, by the manufacturer of the same to a subsequent manufacturer will be considered an overpayment under section 6416(b)(3)(B) if the gasoline is used for nonfuel purposes by the subsequent manufacturer as a material in the manufacture or production of any other article manufactured or produced by the subsequent manufacturer. For this purpose it is immaterial whether the other article is or is not taxable under chapter 32. For provisions relating to the use of gasoline for nonfuel purposes, see section 4221 and the regulations thereunder.

§48.6416(b)(3)-3 Supporting evidence required in case of tax-paid articles used for further manufacture.

(a) *Evidence to be submitted by claimant.* No claim for credit or refund of an overpayment, within the meaning of section 6416(b)(3) and §48.6416(b)(3)-2 shall be allowed unless the subsequent manufacturer submits with the claim the evidence required by §48.6416(a)-3 *and* a statement, supported by sufficient available evidence—

(1) Showing the amount claimed in respect of each category of exportations, uses, or sales on which the claim is based and which give rise to a right of credit or refund under section 6416(b)(3) and §48.6416(b)(3)-1.

(2) Showing the name and address of the manufacturer, producer, or importer of the article in respect of which credit or refined is claimed,

(3) Identifying the article, both as to nature and quantity, in respect of which credit or refund is claimed,

(4) Showing the amount of tax paid in respect of the article by the manufacturer or producer of the article and the date of payment,

(5) Indicating that the article was used by the claimant as material in the manufacture or production of, or as a component part of, a second article manufactured or produced by the manufacturer or was sold on or in connection with, or with the sale of, a second article manufactured or produced by the manufacturer,

(6) Identifying the second article, both as to nature and quantity, and

(7) In the case of an overpayment determined under section 6416(b)(3)(C) as it existed prior to January 1, 1984, and paragraph (d)(1) of §48.6416(b)-(3)-2 in respect of a tire or inner tube taxable under section 4071, indicating that the manufacturer has evidence available (as set forth in paragraph (b) of this section) that the second article is an automobile bus chassis or automobile bus body, or has been exported, used, or sold as provided in section 6416(b)(3)(C)(ii) and §48.6416(b)(3)-2(d)(1)(ii).

(b) *Evidence required to be in pos-*

session of claimant.—(1) *In general.*—The evidence required to be retained by the person claiming credit or refund, as provided in paragraph (a)(7) of this section, must, in the case of an exportation of the second article, consist of proof of exportation of the second article in the form prescribed in the regulations under section 4221, or must, in other cases(except when the second article is an automobile bus chassis or automobile bus body), consist of a certificate, executed and signed by the ultimate purchaser of the second article, in the form prescribed in paragraph (b)(2) of this section. However, if the second article has passed through a chain of sales from the manufacturer of the second article to the ultimate purchaser of the second article, the evidence may consist of a certificate, executed and signed by the ultimate vendor of the second article, in the form provided in paragraph (b)(3) of this section, rather than the proof of exportation itself of the second article or the certificate of the ultimate purchaser of the second article.

(2) *Certificate of ultimate purchaser of second article.* The certificate executed and signed by the ultimate purchaser of the second article must contain the same information as that required in paragraph (b)(1)(ii) of §48.6416(b)(2)-3, except that the information must be furnished in respect of the second article, rather than the article to which the claim relates.

(3) *Certificate of ultimate vendor of second article.* Any certificate executed and signed by an ultimate vendor as evidence to be retained by the person claiming credit or refund must be executed in the same form and manner as that provided in paragraph (b)(2)(iii) and §48.6416(b)(2)-3.

(4) *Repayment or consent of ultimate vendor.* If the person claiming credit or refund of an overpayment to which the section applies has repaid, or agreed to repay, the amount of the overpayment to the ultimate vendor or if the ultimate vendor consents to the allowance of the credit or refund, a statement to that effect, signed by the ultimate vendor, must be shown on, or made a part of, the evidence required to be retained by the person claiming the credit or refund. In this regard, see §48.6416(a)-3(b)(2).

Par. 26. Section 48.6416(b)-4 is removed and the following new §48.6416(b)(4)-1 is added immediately after §48.6416(b)(3)-3.

§48.6416(b)(4)-1 Tax-paid tires or inner tubes used for further manufacture.

(a) *In general.* In the case of any payment of tax under section 4071 on the sale of tires or, prior to January 1, 1984, inner tubes that is determined to be an overpayment under section 6416(b)(4) and paragraph (b) of this section by reason of any exportation, use, or sale described in paragraph (b) of this section, the person who paid the tax may file a claim for refund of the overpayment or may claim a credit for the overpayment or any return of tax under this subpart subsequently filed. No interest shall be paid on any credit or refund allowed under this section. For provisions relating to the evidence required in support of a claim for credit or refund under this section, see §301.6402-2 of this chapter (Regulations on Procedure and Administrations) and paragraph (c) of this section. For provisions authorizing the taking of a credit in lieu of filing a claim for refund, see section 6416(d) and §48.6416(f)-1.

(b) *Conditions causing overpayment.* (1) The payment of tax under section 4071 on the sale of tire or inner tube by the manufacturer of the article will be considered to be an overpayment under section 6416(b)(4) if the tire or inner tube is sold by that manufacturer on or in connection with, or with the sale of, any other article manufactured or produced by that manufacturer and such other article—

(i) Is an automobile bus chassis or an automobile bus body, or

(ii) Is by any person (A) exported to a foreign country or shipped to a possession of the United States, (B) sold to a State, any political subdivision thereof, or the District of Columbia for the exclusive use of a State, any political subdivision thereof, or the District of Columbia, (C) sold to a nonprofit educational organization for its exclusive use, or (D) used or sold for use as supplies for vessels or aircraft.

(2) If the second article is exported or shipped as provided in this paragraph (b), it is immaterial whether the manufacturer sold the article with the knowledge that it would be exported or shipped.

(3) An overpayment arises under paragraph (b)(1) of this section only if the tire or inner tube constitutes a part of, or is associated with, the second article at the time the second article is exported, shipped, sold, used, or sold for use, as prescribed in this paragraph.

(4) Paragraph (b)(1) of this section applies only in those cases where the exportation, use, or sale (or any combination thereof) occurs before any other use.

(5) For definition of certain terms used in this paragraph (b), see section 4221 and the regulations thereunder.

(6) For provisions relating to overpayments arising by reason of the tax-paid sale of tires or inner tubes by the manufacturer of the same and their resale by any person to another manufacturer for use as provided in this paragraph, see section 6416(b)(2)(E) and §48.6416(b)(2)-2(f).

(7) For provisions relating to overpayments arising by reason of the tax-paid sale of tires or inner tubes, directly or indirectly, by the manufacturer of the same, to a subsequent manufacturer who uses them as provided in this paragraph (b), see section 6416(b)(3)(C) as it existed prior to January 1, 1984, and section 6416(b)(3)as amended by the Highway Revenue Act of 1982 and §48.6416(b)(3)-2(d).

(8) For provisions relating to the credit allowable in respect of tires or inner tubes sold on or in connection with, or with the sale of, another article taxable under chapter 32, see section 6416(c) as it existed prior to January 1, 1984, and §48.6416(c)-1.

(9) If a second article referred to in paragraph (b)(1)(ii) of this section is sold for a use described in that paragraph and is not so used, this paragraph (b) is in all respects inapplicable.

(c) *Evidence to be submitted by claimant.* (1) No claim for credit or refund of an overpayment prior to January 1, 1984, within the meaning of section 6416(b)(4) and paragraph (b) of this section, shall be allowed unless the person who paid the tax submits with the claim the evidence required by §48.6416(a)-3(b)(2) and a statement, supported by sufficient available evidence—

(i) Showing the amount claimed in

respect of each category of exportations, uses, or sales on which the claim is based and which give rise to a right of credit or refund under section 6416(b)(4),and paragraph (a) of this section.

(ii) Indicating that the person claiming the credit or refund is the manufacturer of the articles in respect of which credit or refund is claimed.

(iii) Identifying the article, both as to nature and quantity, in respect of which credit or refund is claimed,

(iv) Showing the amount of tax paid in respect of the article and the date of payment of the tax,

(v) Indicating that the person claiming the credit or refund sold the article on or in connection with, or with the sale of, or used the article as a component part of, a second article manufactured or produced by that person,

(vi) Identifying the second article both as to nature and quantity, and

(vii) Indicating that the person claiming the credit or refund has evidence available (as set forth in paragraph (b) of this section) that the second article is an automobile bus chassis or body, or has been exported, used, or sold as provided in section 6416(b)(4)(B)(ii) and paragraph (b)(1)(ii) of this section.

(2) No claim for credit or refund of an overpayment after December 31, 1983, within the meaning of section 6416(b)(4) and paragraph (b) of this section shall be allowed unless the person who paid the tax submits with the claim a statement supported by the evidence listed in paragraph (c)(1)(i) through (vii) of this section.

(d) *Evidence required to be in possession of claimant.*—(1) *In general.*—The evidence required to be retained by the person claiming credit or refund, as provided in paragraph (c)(1)(vii) of this section, must, in the case of an exportation of the second article, consist of proof of exportation of the second article in the form prescribed in the regulations under section 4221 or must, in other cases (except when the second article is an automobile bus chassis or automobile body) consist of a certificate, executed and signed by the ultimate purchaser of the second article, in the form prescribed in paragraph (d)(2) of this section. However, if the second article has passed through a chain of sales from the manufacturer of the second article to the ultimate purchaser of the second article, the evidence may consist of a certificate, executed and signed by the ultimate vendor of the second article, in the form prescribed in paragraph (d)(3) of this section, rather than the proof of exportation itself of the second article or the certificate of the ultimate purchaser of the second article.

(2) *Certificate of ultimate purchaser of second article.* The certificate executed and signed by the ultimate purchaser of the second article must contain the same information as that required in paragraph (b)(1)(ii) of §48.6418(b)(2)-3, except that the information shall be furnished in respect of the second article, rather than the article to which the claim relates.

(3) *Certificate of ultimate vendor of second article.* Any certificate executed and signed by an ultimate vendor as evidence to be retained by the person claiming credit or refund must be executed in the same form and manner as that provided in paragraph (b)(2)(iii) of §48.6416(b)(2)-3.

(4) *Repayment or consent oaf ultimate vendor.* If the person claiming credit or refund of an overpayment to which this section applies, has repaid, or agreed to repay the amount of the overpayment to the ultimate vendor or if the ultimate vendor consents to the allowance of the refund or credit, a statement to the effect, signed by the ultimate vendor, must be shown on, or made a part of, the evidence required to be retained by the person claiming refund or credit. In this regard, see §48.6416(a)-3(b)(2).

Par. 27. Section 48.6416(b)-5 is removed and the following new §48.6416(b)(5)-1 is added immediately after §48.6416(b)(4)-1.

§48.6416(b)(5)-1 Return of installment accounts causing overpayments of tax.

(a) *In general.* In the case of any payment of tax under section 4216(d)(1) in respect of the sale of any installment account that is determined to be an overpayment under section 6416(b)(5) and paragraph (b) of this section upon return of the installment account, the person who paid the tax may file a claim for refund of the overpayment or may claim credit for the overpayment on any return of tax under this subpart which that perso subsequently files. No interest shall b paid on any credit or refund allowe under this section. For provision relating to the evidence required in sup port of a claim for credit or refund un der this section, see §301.6402-2 o this chapter (Regulations on Procedur and Administration) and paragraph (c of this section. For provision authorizing the taking of a credit in lie of filing a claim for refund, see section 6416(d) and §48.6416(f)-1.

(b) *Overpayment of tax allocable t repaid consideration.* The payment o tax imposed by section 4216(d)(1) o the sale of an installment account b the manufacturer will be considered t be an overpayment under sectio 6416(b)(5) to the extent of the tax allo cable to any consideration repaid o credited to the purchaser of the install ment account upon the return of the ac count to the manufacturer pursuant t the agreement under which the accoun originally was sold, if the readjustmen of the consideration occurs pursuant t the provisions of the agreement. Th tax allocable to the repaid or credite consideration is the amount whic bears the same ratio to the total ta paid under section 4216(d)(1) with re spect to the installment account as th amount of consideration repaid or cred ited to the purchaser bears to the tota consideration for which the accoun was sold. This paragraph (b) does no apply where an installment account i originally sold pursuant to the order o or subject to the approval of, a court o competent jurisdiction in a bankruptc or insolvency proceeding.

(c) *Evidence to be submitted b claimant.* No claim for credit or refun of an overpayment, within the meanin of section 6416(b)(5) and paragraph (b of this section, of tax under sectio 4216(d)(1) shall be allowed unless th person who paid the tax submits wit the claim a statement supported by su ficient available evidence, indicating—

(1) The name and address of the pe son to whom the installment accoun was sold.

(2) The amount of tax due under se tion 4216(d)(1) by reason of the sale the installment account, the amount the tax paid under section 4216(d)(with respect to the sale, and the date payment.

(3) The amount for which the installment account was sold,

(4) The amount which was repaid or credited to the purchaser of the account by reason of the return of the account to the person claiming the credit or refund, and

(5)(i) The fact that the amount repaid or credited to the purchaser of the account was so repaid or credited pursuant to the agreement under which the account was sold, and

(ii) The fact that the account was returned to the manufacturer pursuant to that agreement.

Par. 28. Section 48.6416(c)-1 is revised to read as follows:

§48.6416(c)-1 Credit for tax paid on tires or, prior to January 1, 1984, inner tubes.

(a) *Allowance of credit against tax on sale of taxable article.* If tax has been paid under section 4071 on the sale, or under section 4218 on the use, of a tire or inner tube, and the manufacturer of another article taxable under chapter 32 sells the tire or inner tube on or in connection with the sale of that other article, a credit in respect of the tire or inner tube is allowable under section 6416(c) against the tax imposed on the sale of that other article. The amount of the credit is to be determined as provided in paragraph (b) or (c) of this section.

(b) *Tires or tubes purchased by manufacturer of the other article.* If the manufacturer of the other article purchased the tire or inner tube tax-paid, the amount of the credit shall be determined by applying to the purchase price of the tire or inner tube the percentage rate of tax applicable to the sale of the other article. For this purpose, the purchase price shall be determined by including any tax passed on to the manufacturer and, in the case of a tire, by excluding any part of the price attributable to the metal rim or rim base. For example, if the selling price of an automobile truck is $24,000, tax equivalent to 10 percent of the price (*i.e.*, $2,400) is imposed under section 4601(a) on the sale (before April 1, 1983) of the automobile truck. If the tires or inner tubes sold on or in connection with the automobile truck are purchased by the manufacturer of the automobile truck for $1,500 (computed as provided in this paragraph) a credit of $150 (10 percent of $1,500) is allowable against the tax imposed on the sale of the automobile truck.

(c) *Tires or tubes manufactured by manufacturer or other articles.* If the manufacturer of the other article is also the manufacturer of the tire or inner tube and incurs tax liability under section 4218 on the use by that manufacture of the tire or inner tube, the amount of the credit shall be determined by applying to the fair market price of the tire or inner tube, the percentage rate of tax applicable to the sale of the other article. For this purpose, the fair market price of the tire or inner tube shall be the price at which the same or similar tires or inner tubes are sold by manufacturers of tires or inner tubes in the ordinary course of trade, as determined by the Commissioner, and by excluding, in the case of a tire, any part of the price attributable to the metal rim or rim base. The determination of the Commissioner shall be made in the same manner as determinations made under section 4218.

(d) *Other applicable rules.* (1) for purposes of this section, the term "manufacturer" includes the original manufacturer of the other article and any succeeding purchaser of the article who further manufactures the article so as to become liable as a manufacturer of an article taxable under chapter 32. Therefore, the credit provided by section 6416(c) and this section is available both to the original manufacturer of the other article and also to every succeeding purchaser of that article who sells that article on or in connection with, or with the sale of, another article taxable under chapter 32.

(2) No interest shall be paid on any credit allowed under this section.

(3) If credit is not claimed under this section against the tax applicable to the sale of the other article, the manufacturer of the other article may claim refund of an amount equivalent to the credit or may claim credit on any return of tax under this subpart subsequently filed.

Par. 29. Section 48.6416(e)-1 is revised to read as follows.

§48.6416(e)-1 Refund to exporter or shipper.

(a) *In general.* Any payment of tax imposed by section 4041, 4051 or chapter 32 that is determined to be an overpayment within the meaning of section 6416(b)(2)(A) or (E), section 6416(b)(3)(C) (prior to January 7, 1983), or section 6416(b)(4) and the regulations thereunder, by reason of the exportation of any article may be refunded to the exporter or shipper of the article pursuant to section 6416(c) of this section, if—

(1) The exporter or shipper files a claim for refund of the overpayment, and

(2) The person who paid the tax waives the right to claim credit or refund of the tax.

No interest shall be paid on any refund allowed under this section. For provisions relating to the evidence required in support of a claim under this paragraph (a), see §301.6402 of this chapter (Regulations on Procedure and Administration) and paragraph (b) of this section.

(b) *Supporting evidence required.* No claim for refund of any overpayment of tax to which this section applies shall be allowed unless the exporter or shipper submits with that claim, proof of exportation in the form prescribed by the regulations under section 4221, and a statement, signed by the person who paid the tax, showing—

(1) That the person who paid the tax waives the right to claim credit or refund of the tax,

(2) In the case of an overpayment determined under section 6416(b)(2)(A) and paragraph (b) of §48.6416(b)(2)-2 in respect of a truck, bus, tractor, etc., taxable under section 4061(a), that, pursuant to section 6416(g), the person who paid the tax possessed at the time that person shipped the article or at the time title to the article passed to that person's vendee, whichever in earlier, evidence that the article was to be exported to a foreign country or shipped to a possession of the United States.

(3) The amount of tax paid on the sale of the article and the date of payment, and

(4) The internal revenue service office to which the tax was paid.

Par. 30. Section 48.6416(f)-1 is revised to read as follows:

§48.6446(f)-1 Credit on returns.

Any person entitled to claim refund

of any overpayment of tax imposed by section 4041, 4042, 4051 or chapter 32 may, in lieu of claimingrefund of the overpayment, claim credit for the overpayment on any return of tax under this subpart subsequently filed. Any such credit claimed on a return must be supported by the evidence prescribed in the applicable regulations in this subpart and §301.6402 of this chapter (Regulations on Procedure and Administration).

Par. 31. Section 48.6416(g)-1 is revised to read as follows:

§48.6416(g)-1 Intent to export trucks, buses, tractors, etc.

In the case of any payment of tax imposed by section 4061(a) in respect of the sale prior to April 1, 1983, of a truck, bus, tractor, etc., an overpayment of tax will not be considered to arise by reason of an exportation described in section 6416(b)(2)(A) and paragraph (b) of §48.6416(b)(2)-2 unless the manufacturer of the article possessed at the time the article was shipped or at the time title to the article passed to that manufacturer's vendee, whichever is earlier, evidence that the article was to be exported to a foreign country or shipped to a possession of the United States.

Par. 32. Section 48.6416(h)-1 is revised to read as follows:

§ 48.6416(h)-1 Accounting procedures for like articles.

(a) *Identification of manufacturer.* In applying section 6416 and the regulations thereunder, a person who has purchased like articles from various manufacturers may determine the particular manufacturer from whom that person purchased any one of those articles by a first-in-first-out (FIFO) method, by a last-in-first-out (LIFO) method, or by any other consistent method approved by the district director. For the first year for which a person makes a determination under this section, the person may adopt any one of the following methods without securing prior approval by the district director.

(1) FIFO method.

(2) LIFO method.

(3) Any method by which the actual manufacturer of the article is in fact identified.

Any other method of determining the manufacturer of a particular article must be approved by the district director before its adoption. After any method for identifying the manufacturer has been properly adopted, it may not be changed without first securing the consent of the district director.

(b) *Determining amount of tax paid.* In applying section 6416 and the regulations thereunder, if the identity of the manufacturer of any article has been determined by a person pursuant to a method prescribed in paragraph (a) of this section, that manufacturer of the article must determine the tax paid under chapter 32 with respect to that article consistently with the method used in identifying the manufacturer.

Par. 33. Section 48.6420(a)-1, 48.6420(b)-1, 48.6420(c)-1, 48.6420(d)-1, 48.6420(e)-1, 48.6420(f)-1, 48.6420(g)-1, 48.6420(h)-1, and 140.6420-1 are removed. The following new §§48.6420-1, 48.6420-2, 48.6420-03, 48.6420-4, 48.6420-5, 48.6420-6, and 48.6420-7 are added immediately after §48.6416(h)-1.

§48.6420-1 Credits or payments to ultimate purchaser of gasoline used on a farm.

(a) *In general.* If gasoline is used on a farm for farming purposes after June 30, 1965, a credit (under the circumstances described in paragraph (b) of this section) or a payment (under the circumstances described in paragraph (c) of this section) in respect of the gasoline shall be allowed or made to the ultimate purchaser of the gasoline in an amount determined by multiplying (1) the number of gallons of gasoline so used by (2) the rate of tax on gasoline under section 4081 that applied on the date the gasoline was purchased by the ultimate purchaser. No interest shall be paid on any payment, allowed under paragraph (c) of this section. However, interest may be paid on any overpayment (as defined by section 6401 arising from a credit allowed under paragraph (b) of this section. See section 34(a), relating to credit for certain uses of gasoline and special fuels (and lubricating oil used prior to January 7, 1983). See §48.6420-2 for the time within which a claim for credit or payment must be made. See section 4081 and the regulations thereunder for the rates of tax on gasoline. See §48.6420-2 for meaning of the terms "Used on a farm for farming purposes," "farm," "gasoline," "ultimate purchaser," and "taxable year."

(b) *Allowance of income tax credit in lieu of payment.* with respect to persons subject to income tax, repayment of the tax paid under section 4081 on gasoline used on a farm for farming purposes may be obtained only by claiming a credit for the amount of this tax against the income tax imposed by subtitle A of the Code. The amount of the credit shall be an amount equal to the payment which would be made under section 6420 with respect to gasoline used during the taxable year on a farm for farming purposes if section 6420(g)(1) and paragraph (c) of this section did not apply. See section 34(a)(1).

(c) *Allowance of payment.* Payments in respect of gasoline upon which tax was paid under section 4081 that is used on a farm for farming purposes shall be made only to—

(1) The United States or agency or instrumentality thereof, a State, a political subdivision of a State, or an agency or instrumentality of one or more States or political subdivisions of a State, or the District of Columbia, or

(2) An organization which is exempt from tax under section 501(a) and is not required to made a return of the income tax imposed under subtitle A for its taxable year.

(d) *Use of gasoline.* (1) The credit or payment described in paragraph (a) of this section is allowable only in respect of gasoline used on a farm in the United States for farming purposes. The credit or payment is not allowable with respect to gasoline used for nonfarming purposes, or gasoline used off a farm, regardless of the nature of the use. If a vehicle or other equipment is used both on a farm and off the farm, or if it is used on a farm both for farming and nonfarming purposes, the credit or payment is allowable only with respect to that portion of the gasoline which was "used on a farm for farming purposes" as defined in paragraph (a) of §48.6420-4. In determining if this requirement is met, neither the type of equipment or vehicle use nor its registration for highway use is material. However, the actual use of the equipment or vehicle and the place where it is used are material. For example, if a truck used on a farm for farming purposes is also used on the hig

ways, gasoline used in connection with operating the truck on the highways is not taken into account in computing the credit or payment.

(2) For purposes of determining the allowable credit or payment in respect of gasoline used on a farm for farming purposes, gasoline on hand shall be considered used in the order in which it was purchased. Thus, if the owner, tenant, or operator of a farm has on hand gasoline acquired in two purchases made at different times and subject to different rates of tax, in determining credit or payment for gasoline used on a farm for farming purposes, it will be assumed that the gasoline purchased first was the first gasoline used, and the rate applicable to that purchase will apply in determining the credit or payment, until all that gasoline is accounted for.

§48.6420-2 Time for filing claim for credit or payment.

(a) *In general.* A claim for credit or payment described in §48.6420-1 with respect to gasoline used after June 30, 1965, on a farm for farming purposes, shall cover only gasoline used during the taxable year on a farm for farming purposes. Therefore, gasoline on hand at the end of a taxable year as, for example, in fuel supply tanks of farm machinery or in storage tanks or drums, must be excluded from a claim filed for that taxable year (but may be included in a claim failed for a later taxable year if used during that later year on a farm for farming purposes). Gasoline used during a taxable year may be covered by a claim filed for that taxable year although the gasoline was not paid for at the time the claim is filed. For purposes of applying this section, a governmental unit or exempt organization described in §48.6420-1(c) is considered to have as its taxable year, the calendar year or fiscal year on the basis of which it regularly keeps its books; see paragraph (h) of this section.

(b) *Time for filing.* (1) A claim for credit with respect to gasoline used on a farm for farming purposes shall not be allowed unless it is filed no later than the time prescribed by section 6511 and the regulations thereunder for filing a claim for credit or refund of income tax for the particular taxable year.

(2) A claim for payment of a governmental unit or exempt organization described in §48.6420-1(c) must be filed no later than 3 years following the close of its taxable year. (See paragraph (h) of this section).

(3) See §301.7502-1 of this chapter (Regulations on Procedure and Administration) for provisions treating timely mailing as timely filing and §301.7502-1 of this chapter for time for performance of an act where the last day falls on Saturday, Sunday, or a legal holiday.

(c) *Limit of one claim per taxable year.* Not more than one claim may be filed under section 6420 by any person with respect to gasoline used during the same taxable year.

(d) *Form and content of claim.*—(1) *Claim for credit.* (i) The claim for credit with respect to gasoline used on a farm for farming purposes must be made by attaching a Form 4136 to the income tax return of an individual or a corporation. Form 4136 must be executed in accordance with the instructions prescribed for the preparation of the form. A partnership may not file Form 4136. When a partnership files Form 1065, U.S. Partnership Return of Income, it must include a statement showing how many gallons of gasoline are allocated to each partner and the use made of the gasoline.

(ii) If an individual dies during the taxable year, the claim for credit may be made only for that portion of the individual's taxable year ending with the date of death. If a sole proprietorship, a partnership or corporation is terminated or liquidated during the taxable year, the claim for credit may be made only for the portion of its year ending with the date of the termination or liquidation.

(2) *Claim for payment.* The claim for payment with respect to gasoline used on a farm for farming purposes by a governmental unit or exempt organization described in §48.6420-1(c) must be made on Form 843 in accordance with the instructions prescribed for the preparation of the form. The claim by such a unit or organization must be filed with the service center for the internal revenue region in which the principal place of business or principal office of the claimant is located.

§48.6420-3 Exempt sales; other payments or refunds available.

(a)*Exempt sales.* Credits or payments are allowable only for gasoline that was sold by the producer or importer in a transaction that was subject to tax under section 4081. No credit or payment shall be allowed or made under §48.6420-1 with respect to gasoline which was exempt from the tax imposed by section 4081. For example, a State or local government may not file a claim with respect to any gasoline which it purchased tax free from the producer, even through the State or local government used the gasoline on a farm for farming purposes. Similarly, payment may not be made with respect to gasoline purchased by a State tax free for its exclusive use, as provided in section 4221, which is used on a State prison farm for farming purposes.

(b) *Other payments or refunds available.* Any amount which, without regard to the second sentence of section 6420(d) and this paragraph (b), would be allowable as a credit or payable to any person under §48.6420-1 with respect to any gasoline is reduced by any other amount which is allowable as a credit or payable under section 6420, or is refundable under any other provision of the Code, to any person with respect to the same gasoline. Thus, a person who is the ultimate purchaser of gasoline may not file a claim for credit or payment with respect to that gasoline if another person is entitled to claim a payment, credit, or refund with respect to the same gasoline. For example, a State or local government may not file a claim for payment if it has executed, or intends to execute, a written consent to enable the producer to claim a credit or refund for the tax that was paid. See, for example, §§48.6416(a)-3(b)(2), 48.6416(b)(2)-2(d), and 48.6416(b)-(2)-3(b)(1).

§48.6420-4 Meaning of terms.

For purposes of the regulations under section 6420, unless otherwise expressly indicated—

(a) *Used on a farm for farming purposes.* The term "used on a farm for farming purposes" applies only to gasoline which is used (1) in carrying on a trade or business of farming, (2) on a farm in the United States, and (3) for farming purposes. Gasoline used in an aircraft will qualify if its use othewise satisfies these requirements. For the meaning of the term "trade or business

of farming." see paragraph (b) of this section. For the definition of the term "farm," see paragraph (c) of this section. For the definition of the term "farming purposes," see paragraphs (d) through (g) of this section. The term "United States" has the meaning assigned to it by section 7701(a)(9).

(b) *Trade or business of farming.* A person will be considered to be engaged in the trade or business of farming if the person cultivates, operates, or manages a farm for gain or profit, either as an owner or a tenant. A person engaged in forestry or the growing of timber is not thereby engaged in the trade or business of farming. A person who operates a garden plot, orchard, or farm for the primary purpose of growing produce for the person's own use is not considered to be engaged in the trade or business of farming. Generally, the operation of a farm does not constitute the carrying on of a trade or business if the farm is occupied by a person primarily for residential purposes or is used primarily for pleasure, such as for the entertainment of guests or as a hobby.

(c) *Farm.* The term "farm" is used in its ordinary and accepted sense, and generally means land used for the production of crops, fruits, or other agricultural products or for the sustenance of livestock or poultry. The term "livestock" includes cattle, hogs, horses, mules, donkeys, sheep, goats, and captive fur-bearing animals. The term "poultry" includes chickens, turkeys, geese, ducks, and pigeons. Thus, a farm includes livestock, dairy, poultry, fish, fruit, fur-bearing animal, and truck farms, plantations, ranches, nurseries, ranges, orchards, feed yards for fattening cattle, and greenhouses and other similar structures used primarily for the raising of agricultural or horticultural commodities. Greenhouses and other similar structures that are used primarily for purposes other than the raising of agricultural or horticultural commodities do not constitute farms, as, far example, structures that are used primarily for the display, storage, fabrication, or sale of wreaths, corsages, and bouquets. A fish farm is an area where fish are grown or raised, as opposed to merely caught or harvested.

(d) *Gasoline used in cultivating, raising, or harvesting.* Gasoline is used for "farming purposes" when it is used on a farm by the owner, tenant, or operator of the farm in connection with cultivating the soil, raising or harvesting any agricultural or horticultural commodity, or raising, shearing, feeding, caring for, training, or managing livestock, poultry, bees, or wildlife. Examples of operations which are considered to be operations for "farming purposes" within the meaning of this paragraph include plowing, seeding, fertilizing, weed killing, corn or cotton picking, threshing, combining, baling, silo filing, and chopping silage.

(e) *Gasoline used in handling, packing, or storing.* (1) Gasoline is used for "farming purposes" when it is used by the owner, tenant, or operator of the farm in handling, drying, packing, grading, or storing any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant, or operator produced more than one-half of the commodity which was so treated during tthe taxable year for which claim for credit or payment is filed.

(2) Gasoline used in connection with canning, freezing, packaging, or processing operations will not be considered to be used for farming purposes, even though these operations are performed on a farm. Thus, for example, although gasoline used on a farm in connection with the production or harvesting of maple sap or oleoresin from a living tree is considered to be used for farming purposes under paragraph (d) of this section, gasoline used in the processing of maple sap into maple syrup or maple sugar or used in the processing of oleoresin into gum spirits of turpentine or gum resin is not used for farming purposes, even though these processing operations are conducted on a farm.

(3) Gasoline used in connection with processing operations which change a commodity from its raw or natural state, or operations performed with respect to a commodity after its character has been changed from its raw or natural state by a processing operation, will not be considered to be used for farming purposes. For example, gasoline used for the extraction of juices from fruits or vegetables is used in a processing operation which changes the character of the fruits or vegetables from their raw or natural state and will no be considered to be used for "farming purposes."

(4) The term "commodity," as used in this paragraph (e), refers to a single agricultural or horticultural product. For example, all apples are treated as a single commodity while apples and peaches are treated as two separate commodities. Operations with respect to each commodity are to be considered separately in applying the "one-half" production test described in paragraph (e)(1) of this section.

(f) *Gasoline used in planting, cultivating, or caring for trees.* Gasoline is used "for farming purposes" when it is used by the owner, tenant, or operator of the farm in connection with the planting, cultivating, caring for, or cutting of trees that is incidental to the farming operations of the farm on which it is performed or incidental to the farming operations of the owner, tenant, or operator of the farm, or in connection with the preparation (other than milling) of trees for market that is incidental to these farming operations. These operations include the felling of trees and cutting them into logs or firewood but do not include sawing logs into lumber, chipping, or other milling operations. Operations of the prescribed character will be considered incidenial to farming operations only if they are of a minor nature in comparison with the total farming operations involved. Therefore, a tree farmer or timber grower may not claim credit or payment under §38.6420-1 with respect to gasoline used in connection with the trade or business of tree farming or timber growing.

(g) *Gasoline used in the maintenance of a farm or farm equipment.* Gasoline is used "for farming purposes" when it is used by the owner, tenant, or operator of a farm in connection with the operation, management, conservation, improvement, or maintenance of the farm and its tools and equipment. The activities included are those which contribute in any way to the conduct of the farm as such, as distinguished from an other enterprise in which the owner, tenant, or operator may be engaged. Examples of included operations are clearing land, repairing fences and farm, buildings, building terraces or irrigation ditches, cleaning tools or far

machinery, and painting farm buildings. Since the gasoline must be used by the owner, tenant, or operator of the farm to which the operations relate, gasoline used by an organization which contracts with a farmer to renovate his farm properties is not used for farming purposes. Gasoline used in a gasoline powered lawn mower for maintaining a lawn is not used for farming purposes.

(h) *Taxable year.* The "taxable year" of a governmental unit or tax-exempt organization described in §48.6420-1(c) is the calendar or fiscal year on the basis of which it regularly keeps its books. The "taxable year" of persons subject to income tax shall have the meaning as it has under section 7701(a)(23).

(i) *Gasoline.* The term "gasoline" has the same meaning given to this term by section 4082(b) and the regulations thereunder.

(j) *Ultimate purchaser.*—The term "ultimate purchaser" includes only a person who is an owner, tenant, or operator of a farm. A person who is an owner, tenant, or operator of a farm is an ultimate purchaser of gasoline only with respect to such gasoline as is purchased by the person and used for farming purposes on a farm of which the person is the owner, tenant, or operator. Thus the owner of a farm who purchases gasoline which is used on the farm by its owner, tenant, or operator for farming purposes is generally the ultimate purchaser of the gasoline. If, however, the cost of gasoline supplied by an owner, tenant, or operator of a farm, is by agreement or other arrangement borne by a second person who is an owner, or operator of the farm, the second person who bore the cost of the gasoline is considered to be the ultimate purchaser of the gasoline.

(k) *Certain farming use by persons other than the owner, tenant or operator.*—(1) *In general.* Except as provided in paragraph (l) of this section the owner, tenant, or operator of a farm on which gasoline is used by any other person for the purposes described in section 6420(c)(3)(A) and paragraph (d) of this section (relating to gasoline used in cultivating, raising, or harvesting) will be treated, for the purposes of §48.6420-1(a), as the ultimate purchaser who used the gasoline on the farm for farming purposes.

(2) *Example.* The rule of paragraph (k)(1) of this section may be illustrated by the following example.

Example. Farmer A hired custom operator B to cultivate the soil on A's farm. B used 200 gallons of gasoline which B had purchased in performing the work on A's farm. In addition, A hired Farmer C to do some plowing on A's farm, using C's own tractor and 50 gallons of gasoline which C had purchased. A is deemed to be the ultimate purchaser and user of the gasoline used on A's farm by B and C, and A is entitled to take a credit in respect of the gasoline. Accordingly, no credit in respect to the gasoline may be taken by either B or C.

(l) *Aerial applicators treated as ultimate purchasers.*—(1) *General rule.* Section 6420(c)(3)(A) provides that only the owner, tenant, or operator of a farm is entitled to be treated as a user and ultimate purchaser. Section 6420(c)(4) provides that, under section 6420(c)(3)(A), an aerial applicator is entitled to be treated as the user and ultimate purchaser of gasoline used by it on a farm for the purposes described in section 6420(c)(3)(A), but only if the owner, tenant, or operator who is otherwise entitled to treatment as the user and ultimate purchaser waives the right to credit or payment. See paragraph (l)(2) of this section.

(2) *Form and manner of waiver.* To waive the right to be treated as user and ultimate purchaser of gasoline which is used on a farm by an aerial applicator, the owner, tenant, or operator of a farm who is otherwise entitled to treatment as user and ultimate purchaser must execute an irrevocable written agreement (as here described) no later than the date on which the aerial applicator claiming the credit or payment files its return for the taxable year in which the gasoline is used. The agreement must identify the period for which the owner, tenant, or operator waives the right to credit or payment. The effective period of the waiver cannot extend beyond the last day of the taxable year of the owner, tenant, or operator of the farm on which the gasoline was used. If the owner, tenant, or operator's taxable year extends beyond the taxable year of the applicator, the applicator can only claim a credit or payment for periods included in the applicator's taxable year. Periods after the last day of the applicator's taxable year which are included under the agreement must be claimed on the applicator's return for the next succeeding taxable year. The waiver may be in the form shown under paragraph (l)(6) of this section or in any other form that meets the requirements of this paragraph and clearly states that the owner, tenant, or operator of the farm knowingly waives the right to receive the credit or payment.

(3) *Agreement included on aerial applicator's invoice.* The agreement waiving a right to receive a credit or payment under section 6420 may be a separate document or may appear on the voice for aerial application services or other unrelated document from the aerial applicator to the owner, tenant, or operator of the farm. If the waiver agreement appears on an invoice or other unrelated document, however, it must be printed in a section of the invoice or other document clearly set off from all other material contained in the invoice or other document, and it must be printed in type sufficiently large to put the owner, tenant, or operator of the farm on notice that the person has waived the right to receive a credit or payment under section 6420. Additionally, if the waiver agreement appears as part of any invoice or other unrelated document, it must be executed separately from any other item included in the invoice or other document which requires the owner, tenant, or operator's signature.

(4) *Copies of agreement waiving right to credit or payment.* No copies of any agreement waiving a right to credits or payments under section 6420 are to be submitted to the Internal Revenue Service unless a request is made by the Service to the taxpayer for the waivers. Aerial applicators must, however, retain copies of all waivers, and a copy of each waiver must be supplied by the aerial applicator to the owner, tenant, or operator of the farm who waives the right to receive a credit or payment. See regulations §148.6420-6 for general requirements for records to be kept.

(5) *Waiver on behalf of owner, tenant, or operator of farm.* An agent of the owner, tenant, or operator of a farm who is expressly authorized to act on behalf of and to bind the owner, tenant, or operator may waive that person's rights to a credit or payment under section 6420 by signing the waiver on the person's behalf.

(6) *Sample form of agreement.*

While no specific form is required for an effective waiver, an acceptable form waiving the right to receive a credit or payment under section 6420 follows:

I hereby waive my right as onwer/tenant/operator of a farm located at (address) to receive credit or payment from the United States for gasoline used by (aerial applicator) on the farm in connection with cultivating the soil, or the raising or harvesting of any agricultural or horticultural commodity. This waivers applies to gasoline used during the period , both dates inclusive. I understand that by signing this waiver, I give up my right to claim any credit or payment for gasoline used by the aerial applicator during the period indicated, and I acknowledge that I have not previously claimed any credit for that gasoline.

(Signature of Owner/Tenant/Operator)

§48.6420-5 Applicable laws.

(a) *Penalties, excessive claims, etc* All provisions of law, including penalties, applicable in respect of the tax imposed by section 4081 shall, to the extent applicable and consistent with section 6420, apply in respect of the payments provided for in section 6420 to the same extent as if these payments were refunds of overpayments of the tax imposed on the sale of gasoline under section 4081. For special rules applicable to the assessment and collection of amounts constituting excessive payments under section 6420, see section 6206 and the regulations thereunder. For the civil penalty assessable in the case of excessive Claims under section 6420, see section 6675 and the regulations thereunder. For the treatment as an overpayment of an amount allowable as an excessive credit under section 39 with respect to amounts payable under section 6420, see section 6401(b).

(b) *Examination of books and witnesses.* For the purpose of ascertaining (1) the correctness of any claim made under section 6420 or (2) the correctness of any credit or payment made in respect of the claim, the Commissioner shall have the same authority granted by paragraphs (1), (2), and (3) of section 7602, relating to examination of books and witnesses, as if the person claiming credit or payment under section 6420 were the person liable for tax.

(c) *Fractional part of a dollar.* Section 6420(e)(3) provides that section 7504, relating to fractional parts of a dollar, shall not apply with respect to the allowance of any amount as a credit or payment under section 6420. Accordingly, credits or payments authorized by section 6420 shall be made in the exact amount to which the claimant is entitled and shall not be rounded to the nearest whole dollar amount.

§48.6420-6 Records to be kept in substantiation of credits or payments.

(a) *In general.* Every person making a claim for credit or payment under section 6420 must keep records sufficient to enable the district director to determine whether the person is entitled to credit or payment under section 6420 and, if so, the amount of the credit or payment. No particular form is prescribed for keeping the records, but the records must include a copy of the income tax return or claim and a copy of any statement or document subsmitted with the return or claim. The records must also show with respect to the taxable year covered by the claim—

(1) The number of gallons of gasoline purchased and the dates of purchase,

(2) The name and address of each vendor from whom gasoline was purchased and the total number of gallons purchased from each,

(3) The number of gallons of gasoline purchased by the claimant and used during the taxable year for farming purposes on a farm of which the claimant is the owner, tenant, or operator.

(4) The number of gallons of gasoline used during the taxable year for the purposes described in section 6420(c)(3)(A) and §48.6420-4(d) (relating to cultivating, raising, or harvesting) by a person other than the owner, tenant, or operator on a farm of which the claimant is the owner, tenant, or operator, and

(5) Other information as necessary to establish the correctness of the claim.

(b) *Acceptable records.* (1) Evidence of purchases of gasoline, and the purposes for which it was used, to substantiate claims may include paid duplicate sales invoices or tickets from the gasoline dealer or other vendor, and detailed records of all fuel used which show the amount consumed on a farm for farming purposes and the amount used for other purposes.

(2) Records maintained for Federal or State income tax purposes, or to support claims for refund of a State tax on gasoline, may be used to the extent that they contain the information necessary to substantiate the accuracy of the claim for credit under section 6420. However, the records must show separately the number of gallons of gasoline used on a farm for farming purposes.

(3) If trucks or other vehicles are used both on and off the farm, an allocation of gasoline used in the vehicle will be required to show separately the number of gallons of gasoline used on a farm for farming purposes in respect of which the claim is made.

(4) If the owner, tenant, or operator is entitled under section 6420(c)(4)(A) to claim credit or payment in respect of gasoline used on the person's farm by another person other than an owner, tenant, or operator of the farm for a purpose described in section 6420(c)(3)(A) and §48.6420-4(d), the claimant must have records showing (i) the name and address of the person who performed the farming operation, (ii) a description of the type of work (such as plowing, threshing, combining, etc.) and the type of equipment used, (iii) the date or dates on which the work was done, and (iv) the number of gallons of gasoline so used on the claimant's farm.

(c) *Place and period for keeping records.* (1) All records required by this section must be kept by the claimant at a convenient and safe location within the United States which is accessible to internal revenue officers and shall during normal business hours be available for inspection by internal revenue officers. If the claimant has a principal place of business in the United States, the records must be kept at that place of business.

(2) Records required to substantiate a claim under section 6420 must be maintained for a period of at least 3 years from the last date prescribed for the filing of the claim for credit or payment.

§48.64220-7 Cross references.

(a) *Gasoline used by local transit systems or for certain nonhighway purposes other than farming.* For provisions with respect to payments to the ultimate purchaser of gasoline used for certain nonhighway purposes (other than farming) or by local transit systems, see section 6421 and the regulations thereunder.

(b) *Diesel fuel and special motor*

fuels used on a farm for farming purposes. For provisions with respect to exemption from tax in the case of diesel fuel and special motor fuels used on a farm for farming purposes, see section 4041(f) and the regulations thereunder. For credit or payment in respect of special fuels used after June 30, 1970, for farming purposes, see section 6427(c) and §48.6427-1.

Par. 34. Sections 48.6421(a)-1, 48.6421(b)-1, 48.6421(c)-1, 48.6421(d)-1, 48.6421(e)-1, 48.6421(f)-1 and 48.6421(g)-1 are removed and the following new §§48.6421-0, 48.6421-1, 48.6421-2, 48.6421-3, 48.6421-4, 48.6421-5, 48.6421-6, and 48.6421-7 are added immediately after §48.6420-7.

§48.6421-0 Off-highway business use.

For purposes of the regulations under section 6421, after March 31, 1983, the term "off-highway business use" is used in lieu of the term "qualified business use" and has the same meaning as "qualified business use" under §48.6421-4(b).

(a) *In general.* (1) If gasoline is used in qualified business use or as fuel in an aircraft (other than aircraft in noncommercial aviation), a credit (under the circumstances described in paragraph (b) of this section) or a payment (under the circumstances described in paragraph (c) of this section) in respect of the gasoline shall be allowed or made to the ultimate purchaser of the gasoline. For gasoline used in a qualified business use prior to April 1, 1983, the credit or payment under this section shall be an amount equal to 1 cent for each gallon of gasoline so used on which the tax was paid at the rate of 3 cents a gallon, and 2 cents for each gallon of gasoline so used on which the tax war paid at the rate of 4 cents a gallon. For gasoline used in an off-highway business use after March 31, 1983, the credit or payment under this section shall be an amount equal to the amount determined by multiplying the number of gallons so used by the rate at which tax was imposed on such gasoline under section 4081. For gasoline used as a fuel in a aircraft (other than aircraft in noncommercial aviation) the credit or payment under this section shall be an amount equal to the amount determined by multiplying the number of gallons so used by the rate at which tax was imposed on the gasoline under section 4081. No interest shall be paid on any payment allowed under paragraph (c) of this section. However, interest may be paid on any overpayment (as defined by section 6401) arising from a credit allowed under paragraph (b) of this section. See section 34(a), relating to credit for certain uses of gasoline and special fuel and lubricating oil used prior to January 7, 1983. See §48.6421-3 for the time within which a claim for credit or payment must be made under this section. See §48.6421-4 for the meaning of the terms "gasoline," "qualified business use," "noncommercial aviation," and "taxable year."

(2) For purposes of determining the allowable credit or payment in respect of gasoline used in a qualified business use or as fuel in an aircraft (other than aircraft in noncommercial aviation); gasoline on hand shall be considered used in the order in which it was purchased. Thus, if the ultimate purchaser has on hand gasoline acquired in two purchases made at different times and subject to different rates of tax, in determining credit or payment for the gasoline used in a qualified business use or as fuel in an Aircraft (other than aircraft in noncommercial aviation), it will be assumed that the gasoline first purchased was the first gasoline used, and the rate applicable to that purchase will apply in determining the credit or payment, until all that gasoline is accounted for.

(b) *Allowance of income tax credit in lieu of payment.* Except as provided in paragraph (c) of this section, repayment under this section of the tax paid under section 4081 on gasoline used in a qualified business use or as a fuel in an aircraft (other than aircraft in noncommercial aviation) by a person subject to income tax may be obtained only by claiming a credit for the amount of this tax against the tax imposed by subtitle A of the code. The amount of the credit shall be an amount equal to the payment which would be made under section 6421 with respect to gasoline used during the taxable year in a qualified business use or as a fuel in an aircraft (other than aircraft in noncommercial aviation) if section 6421(i) and paragraph (c) of this section did not apply. See section 34(a)92).

(c) *Allowance of payment.* Payments in respect of gasoline upon which tax was paid under section 4081 that is used in a qualified business use or as a fuel in an aircraft (other than aircraft in noncommercial aviation) shall be made only to—

(1) The United States or any agency or instrumentality thereof, a State, a political subdivision of a State, or an agency or instrumentality of one or more State political subdivisions of a State, or the District of Columbia.

(2) An organization which is exempt from tax under section 501(a) and is not required to make a return of the income tax imposed under subtitle A for its taxable year, or

(3) A person described in section 6421(c)(2) to whom $1,000 or more is payable (without regard to paragraph (b) of this section) under this section with respect to gasoline used during any of the first three quarters of the person's taxable year.

(d) *Dual use of gasoline.* (1) No credit or payment may be claimed in respect of gasoline used in a highway vehicle used in a trade or business or for the production of income solely by reason of the fact that the propulsion motor in the vehicle is also used for a purpose other than the propulsion of the vehicle. Thus, if the propulsion motor of a highway vehicle (used in a trade or business or for the production of income) also operates special equipment, such as a mixing unit on a concrete mixer truck or a pump for discharging fuel from a tank truck, by means of a power takeoff or power transfer, no credit or payment may be claimed in respect of the gasoline used to operate the special equipment, even though the special equipment is mounted on the highway vehicle.

(2) If a highway vehicle is equipped with a separate motor to operate the special equipment used in a trade or business or for the production of income, such as a refrigeration unit, pump, generator, or mixing unit, credit or payment may be claimed in respect of the gasoline used in the separate motor.

(3) If gasoline used in a separate motor is drawn from the same tank as the one which supplies gasoline for the propulsion of the highway vehicle, the

determination as to the quantity of gasoline used in the separate motor operating the special equipment must be based on operating experience and supported by records.

(4) Devices to measure the number of miles the highway vehicle has traveled, such as hubometers, may be used in making a preliminary determination of the number of gallons of gasoline used to propel the vehicle. In order to make a final determination of the number of gallons of gasoline used to propel the vehicle, there must be added to this preliminary determination the number of gallons of gasoline consumed while idling or warming up the motor preparatory to propelling the vehicle.

(e) *Gasoline lost or destroyed.* Gasoline lost or destroyed through spillage, fire, or other casualty is not considered to have been "used" in a qualified business use or as fuel in an aircraft (other than aircraft in noncommercial aviation) and, accordingly, credit or payment in respect of the gasoline may not be claimed.

(f) *Supporting evidence required.* Each claim under this section for credit or payment must include a statement showing—

(1) The total number of gallons of gasoline purchased and used during the period covered by the claim in a qualified business use multiplied by the rate of payment allowable in respect of the gasoline. (For the rate of payment allowable, see paragraph (a)(1) of this section.)

(2) The total number of gallons of gasoline purchased and used during the period covered by the claim for use as fuel in an aircraft (other than aircraft in noncommercial aviation) multiplied by the rate of payment allowable in respect of the gasoline.

(3) The purpose or purposes for which the gasoline was used, determined by reference to general categories, and the amount used for each purpose; and

(4) If a claim on Form 843 is being filed, the internal revenue district or service center with which the claimant last filed an income tax return (if any).

§48.6421-2 Credits or payments to ultimate purchasers of gasoline used in intercity, local, or school buses.

(a) *In general.* If gasoline is used in an intercity or local bus while engaged in furnishing (for compensation) passenger land transportation available to the general public or in a school bus engaged in the transportation of students or employees of schools, a credit (under the circumstances described in paragraph (b) of this section) or a payment (under the circumstances described in paragraph (c) of this section) in respect to the gasoline shall be allowed or made to the ultimate purchaser of the gasoline. The credit or payment under this section shall be an amount equal to the product of the number of gallons of gasoline so used multiplied by the rate at which tax was imposed on the gasoline by section 4081. No interest shall be paid on any payment allowed under paragraph (c) of this section. However, interest may be paid on an overpayment (as defined by section 6401) arising from a credit allowed under paragraph (b) of this section. See section 34(a) relating to credit for certain uses of gasoline and special fuels, (and lubricating oil used prior to January 7, 1983). See §48.6421-3 for the time within which a claim for credit or payment must be made under this section. See §48.6421-4 for the meaning of "gasoline." See section 4221(d)(7) and the regulations thereunder for the definition of "intercity bus," "local bus" and "school bus."

(b) *Allowance of income tax credit.* Except as provided in paragraph (c) of this section, repayment under this section of the tax paid under section 4081 of gasoline used while engaged in furnishing (for compensation) passenger land transportation available to the general public or in school bus transportation operations by a person subject to income tax may be obtained only by claiming a credit for the amount of this tax against the tax imposed by subtitle A of the Code. The amount of the credit shall be an amount equal to the payment which would be made under section 6421 with respect to gasoline used during the taxable year for this passenger land transportation or school bus operations if section 6421(i) and paragraph (c) of this section did not apply. See section 34(a)(2).

(c) *Allowance of payment.* Payments in respect of gasoline upon which tax was paid under section 4081 that is used while engaged in furnishing (for compensation) passenger land transportation available to the general public or in school bus transportation operations shall be made only to—

(1) The United States or any agency or instrumentality thereof, a State, or political subdivision of a State, or an agency or instrumentality of one of more States or political subdivisions of a State, or the District of Columbia.

(2) An organization which is exempt from tax under section 501(a) and is not required to make a return of the income tax imposed under subtitle A for its taxable year, or

(3) A person described in section 6421(c)(2) to whom $1,000 or more is payable (without regard to paragraph (b) of this section) under this section with respect to gasoline used during any of the first three quarters of the person's taxable year.

(d) *Supporting evidence required.* Each claim under this section for credit or payment must include a statement showing—

(1) The total number of gallons of gasoline purchased and used during the period covered by the claim for each intercity or local bus while engaged in furnishing (for compensation) passenger land transportation available to the general public multiplied by the rate at which tax was imposed on the gasoline by section 4081.

(2) The total number of gallons of gasoline purchased and used in each bus while engaged in school bus transportation operations multiplied by the rate at which tax was imposed on the gasoline by section 4081, and

(3) If a claim on Form 843 is being filed, the internal revenue district or service center with which the claimant last filed an income tax return (if any).

§§48.6421-3 Time for filling claim for credit or payment.

(a) *In general.* A claim for credit or payment described in §48.6421-1 with respect to gasoline used in a qualified business use or as a fuel in an aircraft (other than aircraft in noncommercial avaiation) or in §48.6421-2 with respect to gasoline used either in an intercity or local bus while engaged in furnishing (for compensation) passenger land transportation available to the general public or in school bus transportation operations, shall cover only gasoline used during the taxable year,

or when paragraph (b)(2) of this section applies, gasoline used during the calendar quarter. Therefore, gasoline on hand at the end of a taxable year, or, if applicable, a calendar quarter, such as gasoline in fuel supply tanks of vehicles or in storage tanks or drums, must be excluded from a claim filed for the taxable year or calendar quarter, as the case may be. However, this gasoline may be included in a claim filed for a later taxable year or a later calendar quarter if it is used during that later year or quarter in a qualified business use, as fuel in an aircraft (other than aircraft in noncommercial aviation), or in intercity, local, or school buses. Gasoline used during the taxable year or calendar quarter may be covered by the claim for that period although the gasoline was not paid for at the time the claim is filed. For purposes of applying this section, a governmental unit or exempt organization described in §48.6421-1(c) or §48.6421-2(c) is considered to have as its taxable year, the calendar year or fiscal year on the basis of which it regularly keeps its books; see §48.6421-(g).

(b) *Time for filing*—(1) *Annual claims.* (i) A claim under this section for credit or payment with respect to gasoline shall not be allowed unless it is filed no later than the time prescribed by section 6511 and the regulations thereunder for filing a claim for credit or refund of income tax for the particular taxable year.

(ii) A claim for payment of a governmental unit or exempt organization described in §48.6421-1(c) or §48.6421-2(c) must be filed no later than 3 years following the close of its taxable year (see §48.6421-4).

(2) *Quarterly claims.* A claim for payment of $1,000 or more in respect of gasoline used during any of the first three quarters of the taxable year, filed either under§48.6421-1(c)(3) in respect of gasoline used in a qualified business use or as a fuel in an aircraft (other than aircraft used in noncommercial aviation) or under §48.6421-2(c)(3) in respect of gasoline used while engaged in furnishing (for compensation) passenger land transportation available to the general public or in school bus operations, shall not be allowed unless the claim is filed on or before the last day of the first calendar quarter following the calendar quarter for which the claim is filed. No quarterly claim may be filed for the last calendar quarter of the taxable year. Amounts for which payment is disallowed under this paragraph (b)(2) merely because the claim was not filed on time may be included in an annual claim filed under paragraph (b)(1) of this section, but other amounts for which a claim for payment has been filed under this paragraph (b)(2) may not be included in an annual claim filed under paragraph (b)(1) of this section.

(3) *Other applicable rules.* See §301.7502-1 of this chapter (Regulations on Procedure and Administration) for provisions treating timely mailing as timely filing and §301.7503-1 of this chapter for time for performance of an act where the last day falls on Saturday, Sunday, or a legal holiday.

(c) *Limit on claims per taxable year.* Not more than one claim may be filed under §48.6421-1 or §48.6421-2 by any person with respect to gasoline used during any taxable year, except to the extent that quarterly claims may be filed under paragraph (b)(2) of this section with respect to any calendar quarter (other than the last calendar quarter) of the taxable year.

(d) *Form and content of claim*—(1) *Claim for credit.* The claim for credit to which this section applies must be made by attaching a Form 4136 to the income tax return of an individual or a corporation. Form 4136 must be executed in accordance with the instructions prescribed for the preparation of the form. A partnership may not file Form 4136. When a partnership files Form 1065, U.S. Partnership Return of Income, it must include a statement showing how many gallons of gasoline are allocated to each partner and the use made of the gasoline.

(2) *Claim for payment.* The claim for payment to which this section applies must be made on Form 843 in accordance with the instructions prescribed for the preparation of the form. Each form must designate the taxable year, or calendar quarter, for which it is filed. The form must be filed with the same service center where the income tax return was last filed or, in the case of a governmental unit or exempt organization described in §48.6421-1(c) or §48.6421-2(c), with the service center for the internal revenue region in which the principal place of business or principal office of the claimant is located.

(3) *Death or termination.* (i) If an individual dies, or if a sole proprietorship, partnership, or corporation is terminated or liquidated, during the taxable year, the claim for credit or payment may be filed in respect of gasoline used during the short taxable year in the same manner as is provided for gasoline used in a full taxable year. Those months which constitute a quarter of a full taxable year will constitute the quarter of the short taxable year. For example, if a corporation using the calendar year is liquidated on September 30, 1982, and is entitled to $900 under §48.6421-1 in respect of gasoline used in a qualified business use for the calendar quarters ending June 30 and September 30, it may file a claim for payment in respect of the gasoline used during the calendar quarters ending June 30, and September 30, 1981, and take a credit of $900 on its income tax return for the short taxable year in respect of the gasoline used during the calendar quarter ending March 31, 1982.

(ii) A claim for payment on behalf of a decedent may be filed by the decedent's executor, administrator, or any other person charged with responsibility for the decenent's affairs. Such a claim must be accompanied by copies of the letters testamentary, letters of administration, or, in the case of a claim filed by other than the executor or administrator, the information called for in Form 1310 (Statement of person Claiming Refund Due a Deceased Taxpayer). The claim may cover only gasoline in respect of which the decedent would have been entitled to claim payment. For example, if an individual dies on July 15, 1982, prior to claiming payment under §48.6421-1 or $1,000 or more applicable to gasoline purchased and used in a qualified business use during the calendar quarter ending June 30, 1982, the decedent's executor or other legal representative may file a claim for payment covering that calendar quarter, and take the credit provided by section 39(a)(2) against the decedent's income tax on the income tax return for the short taxable year in respect of gasoline purchased by the

decedent and so used during the period from July 1, 1982, to July 15, 1982, the date of death.

(e) *Restrictions on claims for credit or payment.* Credits or payments are allowable only in respect of gasoline that was sold by the producer or importer in a transaction that was subject to tax under section 4081. For example, a State or local government may not file a claim with respect to any gasoline which it purchased tax free from the producer, even though the State or local government used the gasoline as a fuel for the purposes described in paragraph (a) of this section. Similarly, a governmental unit or tax-exempt organization that is the ultimate purchaser of gasoline may not file a claim for payment if it is known that another person is entitled to claim credit, payment, or refund with respect to the same gasoline. For example, a State or local government may not file a claim for payment if it has executed, or intends to execute, a written consent, or other documentation, to enable the producer to claim credit or refund for the tax that was paid. See, for example, §§48.6416(a)-3 and 48.6416(b)(2)-3(b)(1).

§48.6421-4 Meaning of terms.

For purposes of the regulations under section 6421, unless otherwise expressly indicated—

(a) *Gasoline.* The term "gasoline" has the same meaning given to such term by section 4082(b) and regulations thereunder.

(b) *Qualified business use.* (1) The term "qualified business use" means any use by a person in a trade or business of the person or in an activity of the person described in section 212 (relating to production of income) otherwise than as a fuel in a highway vehicle—

(i) That at the time of the use is registered, or is required to be registered, for highway use under the laws of any state, the District of Columbia, or a foreign country, or

(ii) That, in the case of a highway vehicles owned by the United States, is used on the highway. The term "qualified business use" does not include any use in a motorboat, other than a vessel used in the fisheries or whaling business. See paragraph (c) of this section for the definition of "highway vehicle." See paragraph (d) of this section for the definition of "highway."

(2) Any highway vehicle operated under a dealer's tag, license, or permit will be considered to be registered. A highway vehicle is not considered to be "registered" solely because there has been issued a special permit for operation of the vehicle at particular times and under specified conditions. However, a highway vehicle that is required to be registered and that is also issued a special permit for operation of the vehicle under specified conditions, such as carrying an oversize load, is still considered to be "registered."

(3) Nonbusiness, off-highway use of gasoline by such vehicles and equipment as minibikes, snowmobiles, power lawn mowers, chain saws, and other yard equipment does not qualify as gasoline used a qualified business use.

(4) Examples of gasoline used in a qualified business use include (i) gasoline used (in a trade or business or for the production of income) in stationary engines to operate pumps, generators, compressors, and power saws; (ii) gasoline used (in a trade or business or for the production of income) for cleaning purposes; (iii) gasoline used (in a trade or business or for the production of income) in forklift trucks, bulldozers, and earthmovers; and (iv) gasoline used by a nonhighway vehicle in connection with the trade or business of construction, mining or logging.

(5) *Illustration.* The application of this paragraph (b) may be illustrated by the following example.

Example. M Corporation, a logging company files its income tax return on the basis of the calendar year. During 1982, the company used 20,000 gallons of gasoline in its logging business. Of this amount, 12,000 gallons were used as fuel in registered highway vehicles which were operated both on the public highways and on the company's private roads. Of the remaining 8,000 gallons, 6,000 were used in nonhighway vehicles, such as tractors and bulldozers, and 2,000 gallons were used in highway vehicles, such as heavy trucks which, at the time of use, were neither registered nor required to be registered under state law for highway use by reason of being operated entirely on the company's property. As the ultimate purchaser, M may take a credit on its income tax return for 1982 under this section in respect of the 6,000 gallons used in the nonhighway vehicles and the 2,000 gallons used in the unregistered highway vehicles. However, no credit may be allowed with respect to the 12,000 gallons used in the registered highway vehicles even though a portion of this gasoline was used in operating the vehicles on the company's own property.

(c) *Highway vehicle.* The term "highway vehicle" has the same meaning assigned to this term under §48.4061(a)-1(d).

(d) *Highway.* The term "highway" includes any road, whether a Federal highway, State highway, city street, or otherwise, in the United States which is not a private roadway.

(e) *Noncommercial aviation.* The term "non-commercial aviation" has the same meaning given to such term by section 4041(c)(4).

(f) *Calendar quarter.* The term "calendar quarter" means a period of three calendar months ending on March 31, June 30, and September 30, or December 31.

(g) *Taxable year.* The "taxable year" of a governmental unit or tax-exempt organization described in §48.6421-1(c) or §48.6421-2(c) is the calendar or fiscal year on the basis of which it regularly keeps its books. The "taxable year" of persons subject to income tax shall have the meaning it has under section 7701(a)(23).

§48.6421-5 Exempt sales; other payments or refunds available.

(a) *Exempt sales.* No credit or payment shall be allowed or made under §48.6421-1 or §48.6421-2 with respect to gasoline which was exempt from the tax imposed by section 4081. For example, credit or payment may not be allowed or made with respect to gasoline purchased tax free for use as supplies for certain, vessels and airplanes, or with respect to gasoline purchased by a State tax free for its exclusive use, as provided in section 4221.

(b) *Other payments or refunds available.* Any amount which, without regard to the second sentence of section 6421(e)(1) and this paragraph (b), would be allowable as a credit or payable to any person under §48.6421-1 or §48.6421-2 is reduced by any other amount which is allowable as a credit or payable under section 6421, or is refundable under any other provision of the Code, to any person with respect to the same gasoline.

(c) *Gasoline used on farms.* Payments with respect to gasoline used on a farm for farming purposes shall be claimed under section 6420 and §48.6420-1, and no claim in respect of

that gasoline may be made under section 6421 and the regulations thereunder.

§48.6421-6 Applicable laws.

(a) *Penalties, excessive claims, etc.* All provisions of law, including penalties, applicable in respect of the tax imposed by section 4081 shall, to the extent applicable and consistent with section 6421, apply in respect of the payments provided for in section 6421 to the same extent as if these payments were refunds of overpayments of the tax imposed on the sale of gasoline by section 4081. For special rules applicable to the assesment and collection of amount constituting excessive payments under section 6421, see section 6206 and the regulations thereunder. For the civil penalty assessable in the case of excessive claims under section 6421, see section 6675 and the regulations thereunder. For the treatment as an overpayment of an amount allowable as an excessive credit under section 34 (section 39 of the Internal Revenue Code of 1954 prior to its revision by the Tax Reform Act of 1984) with respect to amounts payable under section 6421, see section 6401(b).

(b) *Examination of books and witnesses.* For the purpose of ascertaining (1) the correctness of any claim made under section 6421 or (2) the correctness of any credit or payment made in respect of the claim, the Commissioner shall have the same authority granted by paragraphs (1), (2), and (3) of section 7602, relating to examination of books and witnesses, at if the person claiming credits or payment under section 6421 were the person liable for tax.

§48.6421-7 Records to be kept in substantiation of credits or payments.

(a) *In general.* Every person making a claim for credit or payment under section 6421 must keep records sufficent to enable the district director to determine whether the person is entitled to credit or payment under section 6421 and, if so, the amount of the credit or payment. No particular form is prescribed for keeping the records, but the records must include a copy of any statement or document submitted with the return or claim. The records must also show with respect to the period covered by the claim—

(1) The number of gallons of gasoline purchased and the dates of purchase,

(2) The name and address of each vendor from whom gasoline was purchased and the total number of gallons purchased from each.

(3) The number of gallons of gasoline purchased by the claimant and used during the period covered by the claim for nonhighway purposes or in intercity, local or school buses.

(4) Other information as necessary to establish the correctness of the claim.

(b) *Acceptable records.* (1) Evidence of purchases of gasoline, and the purposes for which it was used, to substantiate claims may include paid duplicate sales invoices or tickets from the gasoline dealer or other vendor,and detailed records of all fuel used which show the amount used for the prescribed purpose and the amount used for other purposes.

(2) Records maintained for Federal or State income tax purposes, or to support claims for refund of a State tax on gasoline, may be used to the extent that they contain the information necessary to substantiate the accuracy of the claim for credit under section 6421. However, the records must show separately the number of gallons of gasoline used for nonhighway purposes or in intercity, local, or school buses during the period covered by the claim.

(c) *Place and period of keeping records.* (1) All records required by this section must be kept by the claimant at a convenient and safe location within the United States which is accessible to internal revenue officers and shall during normal business hours be available for inspection by internal revenue officers. If the claimant has a principal place of business in the United States, the records must be kept at that place of business.

(2) Records required to substantiate a claim under section 6421 must be maintained for a period of at least 3 years from the last date prescribed for the filing of the claim for credit or payment.

Par. 35. The following new §§48.6424-0, 48.6424-1, 48.6424-2, 48.6424-3, 48.6424-4, 48.6424-5, and 48.6424-6 are added immediately following §48.6421-7.

§48.6424-0 Effective date.

All references in section 6424 apply to uses prior to January 7, 1983.

48.6424-1 Credits or payments to ultimate purchaser of lubricating oil used in a qualified business use or in a qualified bus.

(a) *In general.* If lubrication oil (other than cutting oils, as defined in section 4092 (b) and other than previously used oil) is used prior to January 7, 1983, in a qualified business use or in a qualified bus, a credit (under the circumstances described in paragraph (b) of this section) or a payment (under the circumstances described in paragraph (c) of this section) in respect of the lubricating oil shall be allowed or made to the ultimate purchaser of the lubricating oil in an amount equal to 6 cents for each gallon of lubricating oil so used on which tax was paid under section 4091. No interest shall be paid on any payment allowed under paragraph (c) of this section. However, interest may be paid on a overpayment (as defined by section 6401) of tax arising from a credit allowed under paragraph (b) of this section. See section 30(a) (prior to its revision by the Tax Reform Act of 1984). relating to credit for certain uses of gasoline, special fuels, and lubricating oil. See §48.6424-2 for the time within which a claim for credit or payment must be made under this section. See §48.6424-3 for the meaning of the terms "lubricating oil," "use in a qualified business use" "qualified bus," "calendar year," and "taxable year."

(b) *Allowance of income tax credit in lieu of payment.* Except as provided in paragraph (c) of this section, repayment under this section of the tax paid under section 4091 on lubricating oil used in a qualified business use or in a qualified bus by a person subject to income tax may be obtained only by claiming a credit for the amount of this tax against the tax imposed by subtitle A of the Code. The amount of the credit shall be an amount equal to the payment which would be made under section 6242 with respect to lubricating oil used dur-

ing the taxable year in a qualified business use or in a qualified bus if section 6424(f) and paragraph (c) of this section did not apply. See section 39(a)(3) (prior to its revision by the Tax Reform Act of 1984).

(c) *Allowance of payment.* Payments in respect of lubricating oil upon which tax was paid under section 4091 that is used in a qualified business use or a qualified bus shall be made only to—

(1) The United States or any agency or instrumentality thereof, a State, a political subdivision of a State, or an agency or instrumentality of one or more States or political subdivisions of a State, or the District of Columbia,

(2) An organization which is exempt from tax under section 501(a) and is not required to make a return of the income tax imposed under subtitle A for its taxable year, or

(3) A person described in section 6424(b)(2) to whom $1,000 or more is payable (without regard to paragraph (b) of this section) under this section with respect to lubricating oil used during any of the first three quarters of the person's taxable year.

(d) *Uses which qualify for credit or payment.* The use contemplated by section 6424 is a use of lubricating oil (previously unused) through which the oil is consumed or rendered unfit for further use as a lubricant or for sale as a lubricant. If previously unused lubricating oil is blended or mixed with previously used lubricating oil which has been reclaimed or rerefined, the unused oil is considered to have lost its identity and the resulting product will be treated as previously used. Thus, no credit or payment will be allowed under this section with respect to the use of such blended lubricating oil regardless of how this mixture is eventually used.

(e) *Dual use of lubricating oil.* (1) No credit or payment may be claimed in respect of lubricating oil used as a lubricant in a highway vehicle used in a trade or business or for the production of income solely by reason of the fact that the propulsion motor in the vehicle is also used for a purpose other than the propulsion of the vehicle. Thus, if the propulsion motor of a highway vehicle (used in a trade or business or for the production of income) also operates special equipment, such as a mixing unit on a concrete mixer truck, by means of a power takeoff or power transfer, no credit or payment may be claimed in respect of the lubricating oil used to operate the special equipment, even through the special equipment is mounted on the highway vehicle.

(2) If a highway vehicle is equipped with a separate motor to operate special equipment (used in a trade or business or for the production of income) such as a refrigeration unit, pump, generator, or mixing unit, the credit or payment may be claimed in respect of the lubricating oil used in the separate motor.

(f) *Lubricating oil lost or destroyed.* Lubricating oil lost or destroyed through spillage, fire, or other casualty is not considered to have been "used" in a qualified business use or in a qualified bus and, accordingly, credit or payment in respect of this lubricating oil may not be claimed.

(g) *Supporting evidence required.* Each claim under this section for credit or payment must include a statement showing—

(1) The total number of gallons of lubricating oil purchased and used in a qualified business or in a qualified bus during the period covered by the claim, multiplied by 6 cents;

(2) The purpose or purposes for which the lubricating oil was used, detemined by reference to general categories, and the amount used for each purpose; and

(3) If a claim on Form 843 is being filed, the internal revenue district or service center with which the claimant last filed an income tax return, if any.

§48.6424-2 Time for filing claim for credit or payment.

(a) *In general.* A claim for credit or payment described in §48.6424-1 with respect to lubricating oil used in a qualified business use or in a qualified bus shall cover only lubricating oil used during the taxable year, or when paragraph (b)(2) of this section applies, used during the clendar quarter, for these purposes. Therefore, lubricating oil on hand at the end of a taxable year, or, if applicable, a calendar quarter, such as lubricating oil in storage tanks or drums, must be excluded from a claim filed for the taxable year or calendar quarter, as the case may be. However, this lubricating oil may be included in a claim filed for a later taxable year or a later calendar quarter if it is used during that later year or quarter in a qualified business or in a qualified bus. Lubricating oil used during the taxable year or calendar quarter may be covered by the claim for that period although the lubricating oil was not paid for at the time the claim is filed. For purposes of applying this section, a governmental unit or exempt organization described in §48.6424-1(c) is considered to have as its taxable year, the calendar year or fiscal year on the basis of which it regularly keeps its books. See §48.6424-3(g).

(b) *Time for filing*—(1) *Annual claims.* (i) A claim under this section for credit or payment with respect to lubricating oil used during a taxable year, shall not be allowed unless it is filed no later than the time prescribed by section 6511 and the regulations thereunder for filing a claim for credit or refund of income tax for the particular taxable year.

(ii) A claim for payment of a governmental unit or exempt organization described in §48.6424-1(c) must be filed no later than 3 years following the close of its taxable year. See §48.64224-3(f).

(2) *Quarterly claims.* A claim for payment of $1,000 or more in respect of lubricating oil used during any of the first three quarters of the taxable year, filed under §48.6424-1(c)(3) in respect of lubricating oil used in a qualified business use or in a qualified bus, shall not be allowed unless the claim is filed on or before the last day of the first calendar quarter following the calendar quarter for which the claim is filed. No quarterly claim may be filed for the last calendar quarter of the taxable year. Amounts for which payment is disallowed under this paragraph (b)(2) merely because the claim was not filed on time may be included in an annual claim filed under paragraph (b)(1) of this section but other amounts for which a claim for payment has been filed under his paragraph (b)(2) may not be included in an annual claim filed under paragraph (b)(1) of this section.

(3) *Other applicable rules.* See §301.7502-1 of this chapter (Regulations on Procedure and Administration) for provisions treating timely mailing as timely filing and §301.7503-1 of this

chapter for time for performance of an act where the last day falls on Saturday, Sunday, or a legal holiday.

(c) *Limit on claims per taxable year.* Not more than one claim may be filed under §48.6424-1 by any person with respect to lubricating oil used during any taxable year, except to the extent that quarterly claims may be filed under paragraph (b)(2) of this section with respect to any calendar quarter (other than the last calendar quarter) of the taxable year.

(d) *Form and content of claim*—(1) *Claim for credit.* The claim for credit to which this section applies must be made by attaching a Form 4136 to the income tax return of an individual or a corporation. Form 4136 must be executed in accordance with the instructions prescribed for the preparation of the form. A partnership may not file Form 4136. When a partnership files Form 1065, U.S. Partnership Return of Income, it must include a statement showing how many gallons of lubricating oil are allocated to each partner and the use made of the lubricating oil.

(2) *Claim for payment.* The claim for payment to which this section applies must be made on Form 843 in accordance with the instructions prescribed for the preparation of the form. Each form must designate the taxable year, or calendar quarter, for which it is filed. The form must be filed with the same service center where the income tax return was last filed or, in the case of a governmental unit or exempt organization described in §48.6424-1(c) with the service center for the internal revenue region in which the principal place of business of principal office of the claimant is located.

(3) *Death or termination.* (i) If an individual dies, or if a sole proprietorship, partnership, or corporation is terminated or liquidated, during the taxable year, the claim for credit or payment may be filed in respect of lubricating oil used during the short taxable year in the same manner as is provided for lubricating oil used in a full taxable year. Those months which constitute a quarter of a full taxable year will constitute the same quarter of the short taxable year. For example, if a corporation using the calendar year is liquidated on September 30, 1982, and is entitled to $900 under §48.6424-1 in respect of lubricating oil used in a qualified business use of in a qualified bus for the calendar quarter ending March 31 and is also entitled to payments of $1,500 for each of the calendar quarters ending June 30 and September 30, it may file a claim for payment in respect of the lubricating oil used during the calendar quarters ending June 30, and September 30, 1982, and take a credit of $900 on the corporation's income tax return for the short taxable year in respect of the lubricating oil used during the calendar quarter ending March 31, 1982.

(ii) A claim for payment on behalf of a decedent may be filed by the decedent's executor, administrator, or any other person charged with responsibility for the decedent's affairs. Such a claim must be accompanied by copies of the letters testamentary, letters of administration, or, in the case of a claim filed by other than the executor or administrator, the information called for in Form 1310 (Statement of Person Claiming Refund Due a Deceased Taxpayer). The claim may cover only lubricating oil in respect of which the decedent would have been entitled to claim payment. For example, if an individual dies on July 15, 1982, prior to claiming payment under §48.6424-1 of $1,000 or more applicable to lubricating oil purchased and used in a qualified business use during the calendar quarter ending June 30, 1982, the decedent's executor or other legal representative may file a claim for payment covering that calendar quarter, and take the credit provided by section 39(a)(3) (prior to its revision by the Tax Reform Act of 1984) against the decedent's income tax on the income tax return for the short taxable year in respect of lubricating oil purchased by the decedent and so used during the period from July 1, 1982, to July 15, 1982, the date of death.

(e) *Restrictions on claims for credit or payment.* Credits or payments are allowable only in respect of lubricating oil that was sold by the manufacturer in a transaction that was subject to tax under section 4091. For example, a State or local government may not file a claim with respect to any lubricating oil which it purchased tax free from the manufacturer, even though the State or local government used the lubricating oil in a qualified business use or in a qualified bus. Similarly, a governmental unit or tax-exempt organization that is the ultimate purchaser of lubricating oil may not file a claim for payment of it if it is known that another person is entitled to claim a credit, payment, or refund with respect to the same lubricating oil. For example, a State or local government may not file a claim for payment if it has executed, or intends to execute, a written consent, or other documentation, to enable the producer to claim a credit or refund for the tax that was paid. See, for example, §§48.6416(a)-3(b)(2), 48.6416(b)(2)-2(d), and 48.6416(b)(2)-3(b)(1).

§48.6424-3 Meaning of terms

For purposes of the regulations under section 6424, unless otherwise expressly indicated—

(a) *Lubricating oil.* The term "lubricating oil" has the same meaning given to this term by the regulations under section 4091. It does not include cutting oil, as defined in section 4092(b) and the regulations thereunder, or any oil which has previously been used.

(b) *Qualified business use.* The term "qualified business use" means any use by a person in a trade or business of such person or in an activity of the person described in section 212 (relating to production of income).

Qualified business use does not include:

(1) use in a highway vehicle which is registered or required to be registered for highway use in any State or foreign country,

(2) use on the highway in a highway vehicle owned by the United States or

(3) use in a motor boat.

Lubricating oil in respect of which credit or payment may be claimed under section 6424 includes, for example, previously unused lubricating oil used—

(i) In stationary engines (used in a trade or business or for the production of income) to operate pumps, generators, compressors, or power saws; or

(ii) In forklift trucks, bulldozers, earthmovers, trench diggers, road graders, farm tractors, cotton pickers, and other motorized agricultural equipment of similar nature, if used in a trade or

business or for the production of income.

(c) *Qualified bus.* The term "qualified bus" has the same meaning assigned to this term by section 4221(d)(7) and the regulations thereunder.

(d) *Highway vehicle.* The term "highway vehicle" has the same meaning assigned to this term under §48.4061(a)-1(d).

(e) *Highway.* The term "highway" includes any road, whether a Federal highway, State highway, city, street, or otherwise, in the United States which is not a private roadway.

(f) *Calendar quarter.* The term "calendar quarter" means a period of three calendar months ending March 31, June 30, September 30, or December 31.

(g) *Taxable year.* The "taxable year" of a governmental unit or a tax-exempt organization described in §48.6424-1(c) is the calendar or fiscal year on the basis of which it regularly keeps its books. The "taxable year" of persons subject to income tax shall have the meaning it has under section 7701(a)(23).

§48.6424-4 Exempt sales; other payments or refunds available.

(a) *Exempt sales.* No credit or payment shall be allowed or made under §48.6424-1 with respect to lubricating oil which was exempt from the tax imposed by section 4091. For example credit or payment may not be allowed or made with respect to lubricating oil purchased tax free for use as supplies for certain vessels and airplanes, or with respect to lubricating oil purchased by a State tax free for its exclusive use, as provided in section 4221.

(b) *Other payments or refunds available.* Any amounts which, without regard to the second sentence of section 6424(c) and this paragraph (b), would be allowable as a credit or payable to any person under §48.6424-1 is reduced by any other amount which is allowable as a credit or payable under section 6424, or is refundable under any other provision of the Code, to any person with respect to the same lubricating oil.

§48.6424-5 Applicable laws.

(a) *Penalties, excessive claims, etc.* All provisions of law, including penalties, applicable in respect of the tax imposed by section 4091 shall, to the extent applicable and consistent with section 6424, apply in respect of the payments provided for in section 6424 to the same extent as if these payments were refunds of overpayments of the tax imposed on the sale of lubricating oil by section 4091. For special rules applicable to the assessment and collection of amounts constituting excessive payments under section 6424, see section 6206 and the regulations thereunder. For the treatment as an overpayment of an amount allowable as an excessive credit under section 39 with respect to amounts payable under section 6424, see section 6401(b).

(b) *Examination of books and witnesses.* For the purpose of ascertaining (1) the correctness of any claim made under section 6424 or (2) the correctness of any credit or payment made in respect of the claim, the Commissioner shall have the same authority granted by paragraphs (1), (2), and (3) of section 7602, relating to examination of books and witnesses, as if the person claiming credit or payment under section 6424 were the person liable for tax.

§48.6424-6 Records to be kept in substantiation of credit or payments.

(a) *In general.* Every person making a claim for credit or payment under section 6424 must keep records sufficient to enable the district director to determine whether the person is entitled to credit or payment under section 6424 and, if so, the amount of the credit or payment. No particular form is prescribed for keeping the records, but the records must include a copy of the income tax return or claim and a copy of any statement or document submitted with the return or claim. The records must also show with respect to the period covered by the claim—

(1) The number of gallons of lubricating oil purchased and the dates of purchase.

(2) The name and address of each vendor from whom lubricating oil was purchased and the total number of gallons purchased from each,

(3) The number of gallons of lubricating oil purchased by the claimant and used, during the period covered by the claim in a qualified business use or in a qualified bus, and

(4) Other information as nec
establish the correctness of the

(b) *Acceptable records.* (1) I
of purchases of lubricating oil,
purposes for which it was used
stantiate claims may include pa
cate sales invoices or tickets
dealer or other vendor, and
records of all lubricating oil use
show the amount used for
scribed purpose and the amo
for other purposes.

(2) Records maintained for
or State income tax purposes, o
port claims for refund of a Stat
lubricating oil, may be used t
tent that they contain the info
necessary to substantiate the
of the claim for credit under
6424.

(c) *Place and period for keep
ords.* (1) All records required
section must be kept by the cla
a convenient and safe locatio
the United States which is acce
internal revenue officers and s
ing normal business hours be
for inspection by internal reve
cers. If the claimant has a p
place of business in the Unite
the records must be kept at th
of business.

(2) Records required to subst
claim under section 6424
maintained for a period of a
years from the last date presc
the filing of the claim for c
payment.

Par. 36. The following §§48
48.6427-1, 48.6427-2, 48.
48.6427-4 and 48.6427-5 are a
mediately following new §48.

§48.6427-0 Off-highway busi
For purposes of the regulatio
section 6427, after March 3
the term "off-highway busi
is used in lieu of the term "
business use" and has th
meaning as "qualified busi
under §48.6421-1(b).

§48.6427-1 Credit or paym
purchaser of special fuels re
used for nontaxable, farm
other purposes.

(a) *Amount of repayme
Nontaxable or other uses.* (i) If
been paid under section 4041(
the sale of diesel fuel for use a

in a diesel-powered highway vehicle or under section 4041(a)(2) on the sale of special motor fuel for use as a fuel in a motor vehicle or a motorboat and the fuel is used by the purchaser for a nontaxable purpose or for a purpose taxable at a lower rate than the purposes for which sold, a credit (under the circumstances described in paragraph (b) of this section) or a payment (under the circumstances described in paragraph (c) of this section) in respect of the fuel shall be allowed or made to the purchaser of the fuel in an amount equal to—

(A) The amount of the tax imposed on the sale of the fuel to the purchaser if the purchaser resells the fuel, or

(B) If the purchaser uses the fuel, the amount of tax imposed on the sale of the fuel to the purchaser, less the amount of tax, if any, that would have been imposed on the purchaser's use of the fuel if no tax had been imposed on the sale of the fuel to the purchaser.

(ii) For purposes of paragraph (a)(1)(i) of this section, and for the regulations under section 6427 applying such paragraph, tax imposed on the sale of fuel will be treated as an overpayment by the purchaser if the person resells the fuel or uses it for a nontaxable purpose or for a purpose taxable at a lower rate than that for which sold to the purchaser. Thus, for example, special motor fuel which was sold tax paid to the purchaser for use otherwise than in a qualified business use in a motor vehicle will qualify for the payment under section 6427 if the purchaser uses it as a fuel in a qualified business use.

(2) *Used for farming purposes.* (i) If tax has been paid under section 4041(a)(1) on the sale of diesel fuel for use as a fuel in a diesel-powered highway vehicle, or under section 4041(a)(2) on the sale of special motor fuel for use as a fuel in a motor vehicle or a motor boat and the fuel is used on a farm for farming purposes, a credit (under the circumstances described in paragraph (b) of this section) or a payment (under the circumstances described in paragraph (c)(1) or (2) of this section) in respect of the fuel shall be allowed or made to the purchaser of the fuel in an amount equal to the amount of tax that was imposed under section 4041 on the sale of the fuel. The provisions of section 6420(c)(1), (2), and (3) and §48.6420-4 shall apply under this paragraph (a)(2) in determining whether the fuel is used on a farm for farming purposes.

(ii) The term "purchaser," as used in paragraph (a)(2)(i) of this section, includes only a person who is an owner, tenant, or operator of a farm. A person who is owner, tenant, or operator of a farm is a purchaser of fuel only with respect to such fuel as is purchased by the person and used for farming purposes on a farm of which the person is the owner, tenant, or operator. Thus the owner of a farm who purchases fuel which is used on the farm by its owner, tenant, or operator for farming purposes is generally the purchaser of the fuel. If, however, the cost of fuel supplied by an owner, tenant, or operator of a farm, is by agreement or other arrangement borne by a second person who is an owner, tenant, or operator of the farm, the second person who bore the cost of the fuel is considered to be the purchaser of the fuel.

(iii) Except as provided in paragraph (a)(2)(iv) of this section, if fuel is used or a farm by any person other than the owner, tenant, or operator for the purposes described in section 6420(c)(3)(A) and §48.6420-4(d) (relating to gasoline used in cultivating, raising, or harvesting), the owner, tenant, or operator (as the case may be) will be treated for the purposes of §48.6427-1(a)(2)(i) as the purchaser who used the fuel on the farm for farming purposes.

(iv) Section 6427(c) provides that an aerial applicator is entitled to be treated as the user and ultimate purchaser of fuel that the applicator uses on a farm for the purposes described in section 6420(c)(3)(A), but only if the owner, tenant, or operator of the farm who is otherwise entitled to be treated as the ultimate purchaser waives the right to credit or payment. The rules contained in section 6420 and the regulations under the section regarding waivers by owners, tenants, and operators of farms of their rights to payments under section 6420 for gasoline used by aerial applicators on a farm for farming purposes apply to waivers under this section.

(3) *Definitions, uses, and other rules.* (i) No interest shall be paid on any payment allowed under paragraph (c) of this section. However, interest may be paid on any overpayment (as defined by section 6401) arising from a credit. See section 34(a), relating to credit for certain uses of gasoline and special fuels. See section 39(a) of the Internal Revenue Code of 1954 prior to its revision by the Highway Revenue Act of 1982, relating to credit for certain uses of lubricating oil. See section 6611, relating to interest on overpayments.

(ii) See §48.6427-3 for the time within which a claim for credit or payment must be made under this section.

(iii) See §48.6420-4 for the meaning of the terms "used on a farm for farming purposes" and "farm." The term "gasoline" has the same meaning given to this term by section 4082(b) and the regulations thereunder. For the meaning of the terms "diesel fuel," "special motor fuel," "motor vehicle," "highway vehicle," and "registered" see section 4041 and the regulations thereunder. The term "fuel" means diesel fuel, special motor fuel, or gasoline, as the context requires. Where appropriate, the term "use" includes a resale. See §48.6421-4 for the meaning of "calendar quarter" and "taxable year".

(iv) For purposes of determining the allowable credit or payment in respect of fuel used for nontaxable purposes, on a farm for farming purposes, or for purposes taxable at a lower rate, fuel on hand shall be considered used in the order in which it was purchased. Thus, if the purchaser made purchases at different times and subject to different rates of tax, then in determining credit or payment for fuel used for a described purpose, it will be assumed that the fuel first purchased was the first fuel used, and the rate applicable to that purchase will apply in determining the credit of payment, until all of that fuel is accounted for.

(v) Fuel lost or destroyed through spillage, fire, or other casualty is not considered to have been "used" within the meaning of this section, and, accordingly, no credit or payment of the tax paid on the sale of the fuel may be made under this section.

(b) *Allowance of income tax credit in lieu of payment.* Except as provided in paragraph (c) of this section, repayment under this section of the tax paid under

section 4041 on fuel used by a person subject to income tax may be obtained only by claiming a credit for the amount of this tax against the tax imposed by subtitle A of the Code. The amount of the credit shall be an amount equal to the payment which would be made under section 6427 with respect to fuel used during the taxable year for nontaxable purposes on a farm for farming purposes, or for purposes taxable at a lower rate, if section 6427(i) and paragraph (c) of this section did not apply. See section 34(a)(3).

(c) *Allowance of payment.* Payments in respect of fuel upon which tax was paid under section 4041 that is used for nontaxable purposes, on a farm for farming purposes, or for purposes taxable at a lower rate, shall be made only to—

(1) The United States or any agency or instrumentality thereof, a State, a political subdivision of a State, or an agency or instrumentality of one or more States or political subdivisions of a State, or the District of Columbia.

(2) An organization which is exempt from tax under section 501(a) and is not required to make a return of the income tax imposed under subtitle A for its taxable year, or

(3) In the case of fuel used for nontaxable purposes to which section 6427(a) applies, to a person described in section 6427(g)(2) to whom $1,000 or more is payable (without regard to paragraph (b) of this section) under this section with respect to fuel used during any of the first three quarters of his taxable year.

(d) *Dual use of fuel.* The principles set forth in §48.4041-7, relating to dual use of fuel, for determining whether liability is incurred under section 4041 at the time of sale of the fuel, are equally applicable in determining whether a credit or payment is to be allowed under this section. Thus, if diesel fuel or special motor fuel used in a separate motor is drawn from the same tank as the one which supplies fuel for the propulsion of the vehicle, a reasonable determination of the quantity of the fuel used in the separate motor will be acceptable for purposes of computing the payment or credit under this section. The determination must be based, however, on the operating experience of the person using the fuel, and a statement, signed by the person, evidencing the operating experience must be maintained as a part of the records of the person claiming the payment or credit.

(e) *Supporting evidence required.* Each claim under this section for credit or payment must include a statement showing—

(1) The total number of gallons of fuel purchased and used for nontaxable or farming purposes during the period covered by the claim, multiplied by the rate of payment allowable under this section with respect to such fuel;

(2) The purpose or purposes for which the fuel was used, determined by reference to general categories, and the amount used for each of the purposes; and

(3) If a claim on Form 843 is being filed, the internal revenue district or service center with which the claimant last filed an income tax return, (if any).

(f) *Illustrations.* the application of this section may be illustrated by the following example:

Example. Special motor fuel was sold for use as fuel in a highway vehicle that was registered for highway use. Tax was imposed on the sale at the rate of 9 cents a gallon under section 4041(a)(2). The special motor fuel was eventually used by the purchaser in a qualified business use. The credit or payment of tax is to be computed as follows:

	Cents per gallon
Rate at which tax was paid	9
Less: Rate at which tax would have been imposed on a qualified business use under sec. 4041(b).	0
New credit or payment under sec. 6427(a)	9

§48.6427-2 Credits or payments to purchaser of diesel or special motor fuels used in intercity, local, or school buses.

(a) *In general.* (1) If tax has been paid under section 4041(a)(1) on the sale of diesel fuel for use as a fuel in a diesel-powered highway vehicle or under section 4041(a)(2) on the sale of special motor fuel for use as a fuel in a motor vehicle or a motorboat and the fuel is used by the purchaser in an intercity or local bus while engaged in furnishing (for compensation) passenger land transportation available to the general public or in a school bus in the transportation of students and employees of schools, a credit (under the circumstances described in paragraph (b) of this section) or a payment (under the circumstances described in paragraph (c) of this section) in respect of the fuel so used shall be allowed or made to the purchaser of the fuel. The credit or payment under this section shall be an amount equal to the product of the number of gallons of fuel so used multiplied by the rate at which tax was imposed on the fuel by section 4041(a)(1) or section 4041(a)(2), reduced as limited by section 6427(b)(2). No interest shall be paid on any payment allowed under paragraph (c) of this section. However, interest may be paid on any overpayment (as defined by section 6401) arising from a credit. See section 34(a), relating to credit for certain uses of gasoline and special fuels, (and lubricating oil prior to January 7, 1983). See section 6611, relating to interest on overpayments. See §48.6427-3 for the time within which a claim for credit or payment must be made under this section.

(2) The terms "diesel fuel" and meaning "special motor fuel" have the same meaning as in section 4041 and the regulations thereunder. The term "fuel" means diesel fuel and special motor fuel. See §46.6421-4 for the meaning of "calendar quarter" and "taxable year."

(b) *Allowance of income tax credit.* Except as provided in paragraph (c) of this section, repayment under this section of the tax paid under section 4041(a)(1) or section 4041(a)(2) on diesel or special motor fuel used while engaged in furnishing (for compensation) passenger land transportation available to the general public or in school bus transportation operations by a person subject to income tax may be obtained only by claiming a credit for the amount of this tax against the tax imposed by subtitle A of the Code. The amount of the credit shall be an amount equal to the payment which would be made under section 6427 with respect to fuel used during the taxable year for passenger land transportation or school bus operations if section 6427(i) and paragraph (c) of this section did not apply. See section 34(a)(3).

(c) *Allowance of payment.* Payments in respect of diesel or special motor fuel upon which tax was paid under

section 4041(a)(1) or section 4041(a)(2) that is used while engaged in furnishing (for compensation) passenger land transportation available to the general public or in school bus transportation operations shall be made only to—

(1) The United States or any agency or instrumentality thereof, a State, a political subdivision of a State, or an agency or instrumentality of one or more States or political subdivisions of a State, or the District fo Columbia,

(2) An organization which is exempt from tax under section 501(a) and is not required to make a return of the income tax imposed under subtitle A for its taxable year, or

(3) A person described in section 6427(g)(2) to whom $1,000 or more is payable (without regard to paragraph (b) of this section) under this section with respect to fuel used during any of the first three quarters of the person's taxable year.

(d) *Supporting evidence required.* Each claim under this section for credit or payment must include a statement showing—

(1) The total number of gallons of fuel purchased and used in each intercity or local bus while engaged in furnishing (for compensation) passenger land transportation available to the general public multiplied by the rate at which tax was imposed on the fuel by section 4041(a)(1) or section 4041(a)(2). See, however, section 6427(b)(2) with respect to the limitation on the amount of credit for buses other than qualified local buses.

(2) The total number of gallons of fuel purchased and used in each bus while engaged in school bus transportation operations multiplied by the rate at which tax was imposed on the fuel by subsection (a)(1) or (a)(2) of section 4041. See, however, section 6427(b)(2) with respect to the limitation on the amount of credit for buses other than qualified local buses.

(3) If a claim on Form 843 is being filed, the internal revenue district or service center with which the purchaser last filed an income tax return (if any).

§48.6427-3 Time for filing claim for credit or payment.

(a) *In general.* A claim for credit or payment described in §48.6427-1 with respect to fuel used for nontaxable, farming, or other purposes taxable at a lower rate or in §48.6427-2 with respect to fuel used either in an intercity or local bus while engaged in furnishing (for compensation) passenger land transportation available to the general public or in school bus transportation operations shall cover only fuel used during the taxable year, or when paragraph (b)(2) of this section applies, used during the calendar quarter. Therefore, fuel on hand at the end of a taxable year, or, if applicable, a calendar quarter, such as fuel in supply tanks of vehicles or in storage tanks or drums, must be excluded from a claim filed for the taxable year or calendar quarter, as the case may be. However, this fuel may be included in a claim filed for a later taxable year or a later calendar quarter if it is used during that later year or quarter for nontaxable or farming purposes, or in an intercity or local bus while engaged in furnishing (for compensation) passenger land transportation available to the general public or in school bus transportation operations. Fuel used during the taxable year or calendar quarter may be covered by the claim for that period although the fuel has not been paid for at the time the claim is filed. The purposes of applying this section, a governmental unit or exempt organization described in §48.6427-1(c) or §48.6427-2(c) is considered to have as its taxable year the calendar year or fiscal year on the basis of which it regularly keeps its books; see §48.6421-4.

(b) *Time for filing*—(1) *Annual claims.* (i) A claim under this section for credit or payment with respect to fuel used during a taxable year shall not be allowed unless it is filed no later than the time prescribed by section 6511 and the regulations thereunder for filing a claim for credit or refund of income tax for the particular taxable year.

(ii) A claim for payment of a governmental unit or exempt organization described in §48.6427-1(c) or unit or exempt organization described in §48.6427-2(c), must be filed no later than 3 years following the close of its taxable year. See §48.6421-4.

(2) *Quarterly claims.* A claim for payment of $1,000 or more in respect to fuel used during any of the first three quarters of the taxable year, filed either under §48.6427-1(c)(3) in respect of fuel used for nontaxable purposes or for purposes taxable at a lower rate, or under §48.6427-2(c)(3) in respect of fuel used while engaged in furnishing (for compensation) passenger land transportation available to the general public or in school bus transportation operations, shall not be allowed unless the claim is filed on or before the last day of the first calendar quarter following the calendar quarter for which the claim is filed. No quarterly claim may be filed for the last calendar quarter of the taxable year. Amounts for which payment is disallowed under this paragraph (b)(2) merely because the claim was not filed on time may be included in an annual claim filed under paragraph (b)(1) of this section, but other amounts for which a claim for payment has been filed under this paragraph (b)(2) may not be included in an annual claim filed under paragraph (b)(1) of this section.

(3) *Other applicable rules.* See §301.7502-1 of this chapter (Regulations on Procedure and Administration) for provisions treating timely mailing as timely filing and §301.7503-1 of this chapter for time for performance of an act where the last day falls on Saturday, Sunday, or a legal holiday.

(c) *Limit on claims per taxable year.* Not more than one claim may be filed under §48.6427-1 or §48.6427-2 by any person with respect to fuel used during any taxable year, except to the extent that quarterly claims may be filed under paragraph (b)(2) of this section with respect to any calendar quarter (other than the last calendar quarter) of the taxable year.

(d) *Form and content of claim.*—(1) *Claim for credit.* The claim for credit to which this section applies must be made by attaching a Form 4136, to the income tax return of an individual or a corporation. Form 4136 must be executed in accordance with the instructions prescribed for the preparation of the form. A partnership may not file Form 4136. When a partnership files Form 1065, U.S. Partnership Return of Income, it must include a statement showing how many gallons of fuel are allocated to each partner and the use made of the fuel.

(2) *Claim for payment.* The claim for payment to which this section applies

must be made on Form 848 in accordance with the instructions prescribed for the preparation of the form. Each form must designate the taxable year, or calendar quarter, for which it is filed. The form must be filed with the same service center where the income tax return was last filed or, in the case of a governmental unit or exempt organization described in §48.6427-1(c) or §48.6427-2(d), with the service center for the internal revenue region in which the principal place of business or principal office of the claimant is located.

(3) *Death or termination.* (i) If an individual dies, or if a sole proprietorship, partnership, or corporation is terminated or liquidated, during the taxable year, the claim for credit or payment may be filed in respect of fuel used during the short taxable year in the same manner as is provided for fuel used in a full taxable year. Those months which constitute a quarter of a full taxable year will constitute the same quarter of the short taxable year. For example, if a corporation using the calendar year is liquidated on September 30, 1982, and is entitled to $900 under §48.6427-1 in respect of fuel used for nontaxable purposes for the calendar quarter ending March 31 and is also entitled to payments of $1,500 for each of the calendar quarters ending June 30 and September 30, it may file a claim for payment in respect of the fuel used for nontaxable purposes during the calendar quarters ending June 30, and September 30, 1982, and take a credit of $900 on its income tax return for the short taxable year in respect of the fuel used during the calendar quarter ending March 31, 1982.

(ii) A claim for payment on behalf of a decedent may be filed by the decedent's executor, administrator, or any other person charged with responsibility for the decedent's affairs. Such a claim must be accompanied by copies of the letters testamentary, letters of administration, or in the case of a claim filed by other than the executor or administrator, the information called for in Form 1310 (Statement of Person Claiming Refund Due a Deceased Taxpayer). The claim may cover only fuel in respect of which the decedent would have been entitled to claim payments. For example, if an individual dies on July 15, 1982, prior to claiming payment under §48.6427-1 of $1,000 or more applicable to fuel purchased and used for nontaxable purposes during the calendar quarter ending June 30, 1982, the decedent's executor or other legal representative may file a claim for payment covering that calendar quarter, and take the credit provided by section 39(a)(3) against the decedent's income tax on the income tax return for the short taxable year in respect of fuel purchased by the decedent and so used during the period from July 1, 1982, to July 15, 1982, the date of death.

(e) *Restrictions on claims for credit or payment.* Credits or payments are allowable only in respect of fuel that was sold by the producer or importer in a transaction that was subject to tax under section 4041. For example, a State or local government may not file a claim with respect to any fuel which it purchased tax free from the producer, even though the State or local government used the fuel for the purposes described in paragraph (a) of this section. Similarly, a State or local government may not file a claim with respect to the use of fuel if it is known that another person is entitled to claim a payment, credit, or refund with respect to the same fuel. For example, a State or local government may not file a claim in respect of tax-paid fuel that has been resold by the purchaser to the State or local government.

§48.6427-4 Applicable laws.

(a) *Penalties, excessive claims, etc.* All provisions of law, including penalties, applicable in respect of the tax imposed by section 4041 shall, to the extent applicable and consistent with section 6427, apply in respect of the payments provided for in section 6427 to the same extent as if these payments constituted refunds of overpayments of the tax imposed on the sale of fuels by section 4041. For special rules applicable to the assessment and collection of amounts constituting excessive payments under section 6427, see section 6206 and the regulations thereunder. For the civil penalty assessable in the case of excessive claims under section 6427, see section 6675 and the regulations thereunder. For the treatment as an overpayment of an amount allowable as an excessive credit under section 34 with respect to amounts payable under section 6427, see section 6401(b).

(b) *Examination of books and witnesses.* For the purpose of ascertaining (1) the correctness of any claim made under section 6427 or (2) The correctness of any credit or payment made in respect of the claim, the Commissioner shall have the same authority granted by paragraphs (1), (2), and (3) of section 7602, relating to examination of books and witnesses, as if the person claiming credit or payment under section 6427 were the person liable for tax.

§48.6427-5 Records to be kept in substantiation of credits or payments.

(a) *In general.* Every person making a claim for credit or payment under section 6427 must keep records sufficient to enable the district director to determine whether the person is entitled to credit or payment under such section and, if so, the amount of the credit or payment. No particular form is prescribed for keeping the records, but the records must include a copy of the income tax return or claim and a copy of any statement or document submitted with the return or claim. The records must also show with respect to the period covered by the claim—

(1) The number of gallons of fuel purchased and the dates of purchase,

(2) The name and address of each vendor from whom fuel was purchased and the total number of gallons purchased from each,

(3) The number of gallons of fuel purchased by the claimant and used during the period covered by the claim for nontaxable purposes, farming purposes, for other purposes taxable at a lower rate, in local, intercity, or school buses, and

(4) Other information as necessary to establish the correctness of the claim.

(b) *Acceptable records.* (1) Evidence of purchases of fuel, and the purposes for which it was used, to substantiate claims may include paid duplicate sales invoices or tickets from the fuel dealer or other vendor, and detailed records of all fuel used which show the amount used the prescribed purposes and the amount used for other purposes.

(2) Records maintained for Federal or State income tax purposes, or to support claims for refund of a State tax on

fuel, may be used to the extent that they contain the information necessary to substantiate the accuracy of the claim for credit under section 6427. However, the records must show separately the number of gallons of fuel used for nontaxable purposes, farming purposes, other purposes taxable at a lower rate, or in intercity, local, or school buses during the period covered by the claim.

(c) *Place and period for keeping records.* (1) All records required by this section must be kept by the claimant at a convenient and safe location within the United States which is accessible to internal revenue officers and shall during normal business hours be available for inspection by internal revenue officers. If the claimant has a principal place of business in the United States, the records must be kept at the place of business.

(2) Records required to substantiate a claim under section 6427 must be maintained for a period of at least 3 years from the last date prescribed for the filing of the claim for credit or payment.

Par. 37. Section 48.6675-1 is revised to read as follows:

§48.6675-1 Excessive claims under section 6420, 6421, 6424, or 6427.

(a) *Civil penalty.* Any person making a claim for credit or payment under section 6420 (relating to gasoline used on farms), section 6421 (relating to gasoline used for certain non-highway purposes or by local transit systems), section 6424 (relating to lubricating oil used for certain nontaxable purposes prior to January 7, 1983), or section 6427 (relating to fuels not used for taxable purposes) for an excessive amount shall be liable, in addition to any criminal penalty provided by law, to penalty in an amount equal to the greater of either (1) two times the excessive amount or (2) ten dollars, unless the person shows that the making of the excessive claim was due to reasonable cause. For provisions relating to the assessment and collection of the civil penalty provided by section 6675, see section 6206 and the regulations thereunder.

(b) *Excessive amount defined.* For purposes of section 6675(a), the term "excessive amount" means the amount by which—

(1) The claim for credit or payment under section 6420, section 6421, section 6424 or section 6427 exceeds

(2) The amount of credit or payment under the section for the period covered by the claim.

Par. 38. The authority citation for Part 154 remains unchanged.

Par. 39. Paragraph (e) of §154.4-1 (Temporary Regulations in connection with the Airport and Airway Revenue Act of 1970) is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 40. The authority citation for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 41. Section 602.101(c) is amended as follows:

1. The following tabular entries are inserted in the appropriate places in the table:

"§48.0-1	1545-0723
48.4048-1	1545-0725
48.4091-0	1545-0725
48 4092-1	1545-0725
48.4101-1	1545-0725
48.4102-1	1545-0725
48.4161(a)-1	1545-0723
48.4161(a)-2	1545-0723
48.4161(a)-3	1545-0723
48.4161(b)-1	1545-0723
48.4181-2	1545-0723
48.4182-2	1545-0723
48.6011(a)-1	1545-0723
48.6011(a)-2	1545-0723
48.6071(a)-1	1545-0723
48.6081(a)-1	1545-0723
48.6091-1	1545-0723
48.6101-1	1545-0723
48.6109-1	1545-0723
48.6416(a)-1	1545-0723
48.6416(a)-2	1545-0723
48.6416(a)-3	1545-0723
48.6416(b)(1)-1	1545-0723
48.6416(b)(1)-2	1545-0723
48.6416(b)(1)-3	1545-0723
48.6416(b)(1)-4	1545-0723
48.6416(b)(2)-1	1545-0723
48.6416(b)(2)-2	1545-0723
48.6416(b)(2)-3	1545-0723
48.6416(b)(2)-4	1545-0723
48.6416(b)(3)-1	1545-0723
48.6416(b)(3)-2	1545-0723
48.6416(b)(3)-3	1545-0723
48.6416(b)(4)-1	1545-0723
48-6416(b)(5)-1	1545-0723
48.6416(c)-1	1545-0723
48.6416(e)-1	1545-0723
48.6416(f)-1	1545-0723
48.6416(g)-1	1545-0723
48.6416(h)-1	1545-0723
48.6420-1	1545-0723
48.6420-2	1545-0723
48.6420-3	1545-0723
48.6420-4	1545-0723
48.6420-5	1545-0723
48.6420-6	1545-0723
48.6420-7	1545-0723
48.6421-0	1545-0723
48.6421-1	1545-0723
48.6421-2	1545-0723
48.6421-3	1545-0723
48.6421-4	1545-0723
48.6421-5	1545-0723
48.6421-6	1545-0723
48.6421-7	1545-0723
48.6424-0	1545-0723
48.6424-1	1545-0723
48.6424-2	1545-0723
48.6424-3	1545-0723
48.6424-4	1545-0723
48.6424-5	1545-0723
48.6424-6	1545-0723
48.6424-7	1545-0723
48.6427-0	1545-0723
48.6427-1	1545-0723
48.6427-2	1545-0723
48.6427-3	1545-0723
48.6427-4	1545-0723
48.6427-5	1545-0723
48.6675-1	1545-0723

2. The entry in the table reading "§48.0-5 .... 1545-0685" is revised to read: "§48.0-3 .... 1545-0685".

3. The following tabular entries are removed from the table:

" 6416(b)-1(d)	1545-0023
6416(b)-2(b)	1545-0023
6416(b)-2(c)	1545-0023
6416(b)-3(a) and (c)	1545-0023
6416(b)-4(c)	1545-0023
6416(b)-5(c)	1545-0023
6420(f)-1(a) and (b)	1545-0023
6420(c)-2(c), (d) and (e)	1545-0023
6421(c)-1(a), (b), (c), (d)	1545-0024
6421(g)-1(a), (b), (c)	1545-0024."

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved July 18, 1985.

RONALD A. PEARLMAN,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on August 7, 1985, 8:45 a.m., and published in the issue of the Federal Register for August 8, 1985, 50 F.R. 32012)

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26 CFR 48.4161(a)-2: Meaning of terms
(Also Section 4162.)

Manufacturers; sporting goods; fishing spear guns. Effective October 1, 1984, sales of spear guns designed for underwater deep sea fishing are subject to tax on sport fishing equipment imposed by section 4161 of the Code. Such sales continue to be exempt from the tax on firearms imposed by section 4181. Rev. Rul. 58-82 superseded.

Rev. Rul. 85-149

The Internal Revenue Service has reconsidered Rev. Rul. 58-82, 1958-1 C.B. 421, because of amendments made to the Internal Revenue Code by the Tax Reform Act of 1984, Pub. L. No. 98-369, 1984-3 (Vol. 1) C.B. 1, 525 (the Act). Rev. Rul. 58-82 held that a spear gun designed for underwater deep sea fishing and powered by rubber bands or rubber tubes was not subject to (1) the manufacturers excise tax on certain fishing equipment imposed by section 4161 of the Code, or (2) the manufacturers excise tax on firearms imposed by section 4181 of the Code.

Section 4161(a) of the Code, as amended by seciton 1015(a) of the Act, effective October 1, 1984, imposes a tax of 10 percent of the selling price on the sale of any sport fishing equipment by the manufacturer, producer, or importer.

Section 4162(a) of the Code, as added by section 1015(b) of the Act, effective October 1, 1984, defines the term "sport fishing equipment" and, in so doing, expands the types of fishing equipment subject to the tax imposed by section 4161(a). The term "sport fishing equipment" is defined in section 4162(a)(4) to include fishing spears, spear guns, and spear tips.

Accordingly, effective October 1, 1984, sales by the manufacturer, producer, or importer of the type of spear gun described above are subject to the tax imposed by section 4181.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 58-82 is superseded, effective October 1, 1984.

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26 CFR 48.4161(a)-2: Meaning of terms.
(Also Section 4162.)

Manufacturers; sporting goods; fishing equipment. Effective October 1, 1984, sales of portable bait containers, fish hook extractors, fishing tackle boxes, gaff hooks, and landing nets are subject to the tax imposed by section 4161(a)(1) of the Code. Sales of casting nets, fish tank aerators, lure retrievers, retrieving lines and sinkers for nets, scent oil for bait, and wire minnow traps remain not subject to the tax. Rev. Rul. 58-606 modified and superseded.

Rev. Rul. 85-150

ISSUE

Whether sales of certain items related to fish and fishing are subject to the manufacturers excise tax on sport fishing equipment.

FACTS

The Internal Revenue Service has reconsidered Rev. Rul. 58-606, 1958-2 C.B. 805, because of amendments made to the Internal Revenue Code by the Tax Reform Act of 1984, Pub. L. No. 98-369, 1984-3 (Vol. 1) C.B. 1, 525 (the Act). Rev. Rul. 58-606 holds that sales by the manufacturer, producer, or importer of bait boxes, casting nets, fish hook extractors, fishing tackle boxes, fish tank aerators, gaff hooks, landing nets, lure retrievers, retrieving lines and sinkers for nets, scent oil for bait, and wire minnow traps are not subject to the manufacturers excise tax imposed by section 4161(a) of the Code, when sold either separately or with taxable articles.

LAW AND ANALYSIS

Section 4161(a)(1) of the Code, as amended by section 1015(a) of the Act, effective October 1, 1984, imposes a tax of 10 percent of the selling price on the sale of an article of sport fishing equipment by the manufacturer, producer, or importer.

Section 4162(a)(6) of the Code, as added by section 1015(b) of the Act, effective October 1, 1984, defines the term "sport fishing equipment" to include, among other items, tackle boxes, portable bait containers, landing nets, gaff hooks, and fishing hook disgorgers. As compared to prior law, this definition expands the types of fishing equipment subject to the tax imposed by section 4161(a).

HOLDING

Accordingly, sales of portable bait containers, fish hook extractors, fishing tackle boxes, gaff hooks, and landing nets are subject to the 10 percent manufacturers excise tax imposed by section 4161(a)(1) of the Code, effective October 1, 1984.

Sales of casting nets, fish tank aerators, lure retrievers, retrieving lines and sinkers for nets, scent oil for bait, and wire minnow traps remain not subject to the section 4161(a)(1) tax.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 58-606 is modified and, as modified, is superseded, effective October 1, 1984.

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26 CFR 48.4161(a)-2: Meaning of terms.
(Also Section 4162.)

Manufacturers; sporting goods; fishing rods. Effective October 1, 1984, sales of the following articles enumerated in *Situations (1)* through *(4)* of Rev. Rul. 59-136 are subject to the tax imposed by section 4161(a)(1) of the Code. *Situation (1),* rod blanks; *Situation (2),* detachable rod handles; *Situation (3),* rod blanks with handles and reel seats affixed; *Situation (4),* fishing rod kits. The local distributor in *Situation (5)* of Rev. Rul. 59-136 is liable for the tax imposed by section 4161(a)(1). Rev. Rul. 59-136, as modified by Rev. Rul. 70-548, is further modified and, as modified, superseded.

Rev. Rul. 85-151

ISSUE

Whether certain components of fishing rods and poles are subject to the manufacturers excise tax on sport fishing equipment.

FACTS

The Internal Revenue Service has reconsidered Rev. Rul. 59-136, 1959-1 C.B. 342, as modified by Rev. Rul. 70-548, 1970-2 C.B. 265, because of amendments made to the Internal Revenue Code by the Tax Reform Act of 1984, Pub. L. No. 98-369, 1984-3 (Vol. 1) C.B. 1, 525 (the Act). In *Situation (1)* of Rev. Rul. 59-136, a manufacturer cut fiberglass rods, either solid or tubular, into sections of desired lengths and attached ferrules to the ends of some of the sections. The manufacturer then sold these fishing rod "blanks" to other companies, which produced complete fishing rods. The revenue ruling holds that the blanks have not reached a stage of manufacture at which they are suitable for fishing purposes and, thus, that they are not fishing rods subject to the manufacturers excise tax imposed by section 4161 of the Code.

In *Situation (2)* a manufacturer sold detachable handles that may be used on any type of fishing rod. Rev. Rul. 59-136 holds that the detachable handles are not subject to the manufacturers excise tax.

In *Situation (3)*, a manufacturer sold fishing rod blanks with handles and reel seats affixed. Some of the blanks had guides attached while some did not. The rod blanks with handles and reel seats affixed are held to be subject to the manufacturers excise tax.

In *Situation (4)*, a manufacturer sold a fishing rod kit, consisting of a rod blank, a handle and reel seat, thread, guides, and varnish. Rev. Rul. 59-136 holds that the kid is a fishing rod and is subject to the manufacturers excise tax. It holds further, however, that the sale of a kit consisting only of the guides, silk thread, and varnish is not subject to tax.

In *Situation (5)*, a local distributor purchased fishing rod blanks with ferrules, like those described in *Situation (1)*, and sent these blanks to a local shop to have handles and reel seats attached. The local shop returned the blanks to the local distributor and charged only for the material and labor involved in attaching the handles and reel seats. The local distributor sold them to customers. Rev. Rul. 59-136 holds that the distributor is a manufacturer and is liable for manufacturers excise tax on the sale of the fishing rods.

LAW AND ANALYSIS

Section 4161(a)(1) of the Code, as amended by section 1015(a) of the Act, effective October 1, 1984, imposes a tax on the sale of any sport fishing equipment by the manufacturer, producer, or importer.

Section 4162(a) of the Code, as added by section 1015(b) of the Act, effective October 1, 1984, defines the term "sport fishing equipment" to include fishing rods and poles (and component parts therefor). The Act thus expanded the types of fishing equipment subject to the tax imposed by section 4161(a).

The House and Senate reports both specifically state that component parts include rod handles, guides, reel seats, blank rods, tip-tops, ferrules, and any other devices which are designed to be attached to such poles or rods for use in fishing. S. Rep. No. 98-169, Vol. 1, 98th Cong., 2d Sess. 740 (1984); H.R. Rep. No. 98-133, Part 2, 98th Cong., 1st Sess. 6 (1983), 1984-3 (Vol. 2) C.B. 555, 560.

HOLDING

As a result of the inclusion of component parts of rods and poles in the class of taxable articles, effective October 1, 1984, sales by the manufacturer, producer, or importer of the rod blanks described in *Situation (1)*, the detachable rod handles described in *Situation (2)*, the rod blanks with handles and reel seats attached described in *Situation (3)*, and each of the fishing rod kits, including the kit consisting only of guides, silk thread, and varnish, described in *Situation (4)* of Rev. Rul. 59-136 are subject to the tax imposed by section 4161(a)(1) of the Code. The local distributor in *Situation (5)* of Rev. Rul. 59-136 is a manufacturer and is liable for the tax imposed by section 4161(a)(1) on the sale of the fishing rods.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 59-136, as modified by Rev. Rul. 70-548, is further modified and, as modified, is superseded.

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26 CFR 48.4161(a)-2: Meaning of terms. (Also Section 4162.)

Manufacturers; sporting goods; fishing equipment. Effective October 1, 1984, sales of fishing tackle and artificial lures enumerated in *Situations (1)* and *(2)* of Rev. Rul. 60-225, except for the beads in *Situation (1)* when sold separately, are subject to the tax imposed by section 4161(a)(1) of the Code. Rev. Rul. 60-225 superseded.

Rev. Rul. 85-152

ISSUE

Whether certain items of terminal tackle and certain components of artificial lures are subject to the manufacturers excise tax on sport fishing equipment.

FACTS

The Internal Revenue Service has reconsidered Rev. Rul. 60-225, 1960-1 C.B. 489, because of amendments made to the Internal Revenue Code by the Tax Reform Act of 1984, Pub. L. No. 98-369, 1984-3 (Vol. 1) C.B. 1, 525 (the Act). In *Situation 1* of Rev. Rul. 60-225, a corporation manufactures and sells various articles that are designed for use by fishermen. Included among these articles are different sizes and styles of "blades." These blades are stamped from copper or brass sheets, after which they undergo a finishing process. After the blades are plated or lacquered, the manufacturer sells some of them separately, either to vendees for resale as such or to other manufacturers for use in further manufacture of other articles. In some instances, the manufacturer of the blades attaches to some of them certain other items, which include various combinations of plastic, glass, or fluorescent beads, fishhooks, shot (a type of sinker), swivels, or sinker assortments. The articles thus produced are then sold by the manufacturer. The corporation sometimes sells separately the beads, fish hooks, shot, swivels, or sinker assortments.

In *Situation 2*, another corporation produces and sells various articles of fishing equipment, including (1) spinners, (2) a "worm harness," consisting of a spinner and beads, (3) a "worm harness" equipped with a plastic worm, (4) a "fishing rig," which includes a spinner and a bead, (5) a lure which consists of a spoon, beads, a hook, and a leader, and which is designed to be used with live bait, (6) a clear plastic

float which is designed to look like a natural bubble in the water, and (7) a colored plastic float, the color and water action of which is said to bring fish within striking distance of a lure.

Rev. Rul. 60-225 holds that the beads, fish hooks, shot, swivels, and sinkers in *Situation 1*, when sold separately, are not artificial lures subject to the manufacturers excise tax imposed by section 4161(a) of the Internal Revenue Code, but that the blades, whether sold separately, or with the beads, fish hooks, shot, swivels, or sinkers attached, are artificial lures subject to the tax. The revenue ruling further holds that all of the items in *Situation 2*, with the exception of the clear plastic or colored plastic floats, are artificial lures subject to the tax. The floats are held to be not taxable.

LAW AND ANALYSIS

Section 4161(a)(1) of the Code, as amended by section 1015(a) of the Act, effective October 1, 1984, imposes a tax on the sale of any sport fishing equipment by the manufacturer, producer, or importer.

Section 4162(a)(5) of the Code, as added by section 1015(b) of the Act, effective October 1, 1984, defines the term "sport fishing equipment" to include items of terminal tackle, including—

(A) leaders,
(B) artificial lures,
(C) artificial baits,
(D) articial flies,
(E) fishing hooks,
(F) bobbers,
(G) sinkers,
(H) snaps,
(I) drayles [*sic*], and
(J) swivels,

but not including natural bait or any item of terminal tackle designed for use and ordinarily used on fishing lines over 130 pounds test. This definition expands the types of fishing equipment subject to the tax imposed by section 4161(a)(1).

All the items described in *Situations (1)* and *(2)* constitute "sport fishing equipment" under section 4162(a)(5) of the Code, except for the beads in *situation (1)* when sold separately by the manufacturer.

HOLDING

Effective October 1, 1984, sales by the manufacturer, producer, or importer of all the items described in *Situations (1)* and *(2)*, except for the beads in *Situation (1)* when sold separately, are subject to the manufacturers excise tax imposed by section 4161(a)(1) of the Code.

EFFECTIVE ON OTHER REVENUE RULINGS

Rev. Rul. 60-225 is superseded, effective October 1, 1984.

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26 CFR 48.4161(a)-2: Meaning of terms. (Also Section 4162.)

Manufacturers; sporting goods; ice fishing tip-ups; spear fishing decoys. Effective October 1, 1984, sales of ice fishing tip-ups are subject to the tax imposed by section 4161(a)(1) of the Code. Sales of spear fishing decoys remain taxable under section 4161(a)(1). Rev. Rul. 78-108 modified and superseded.

Rev. Rul. 85-153

ISSUE

Whether ice fishing tip-ups and spear fishing decoys are subject to the manufacturers excise tax on sport fishing equipment.

FACTS

The Internal Revenue Service has reconsidered Rev. Rul. 78-108, 1978-1 C.B. 354, because of amendments made to the Internal Revenue Code by Section 1015 of the Tax Reform Act of 1984, Pub. L. No. 98-368, 1984-3 (Vol. 1) C.B. 1, 525 (the Act). The issue of Rev. Rul. 78-108 was whether certain ice fishing tip-ups and spear fishing decoys were subject to the manufacturers excise tax, which section 4161(a) of the Internal Revenue Code at that time imposed on certain sporting goods.

The ice fishing tip-up consists of a spool on a spindle and a spring mounted flag on opposite ends of a vertical pole that is attached to two horizontal cross members. The cross members rest on the rim of a hole cut in the ice and support the pole over the hole. When fixed in place, the spool is under the water and the flag is above the ice.

The spearing decoys are made from plastic or rubber and are designed to simulate small fish 4¾ to 10 inches long. The decoys are not used with hooks but each has a single eyelet for attachment to a line. The decoys are designed so that when they are placed in water and the line is pulled the decoys will move in a circular manner to attract fish.

Rev. Rul. 78-108 held that the spear fishing decoys are artificial lures subject to the manufacturers excise tax imposed by section 4161(a) of the Code, and that the ice fishing tip-up, was not a rod subject to the tax imposed by section 4161(a). The revenue ruling also held that the spool, which was a component of the tip-up, was not a reel subject to the tax.

LAW AND ANALYSIS

Section 4161(a)(1) of the Code, as amended by section 1015(a) of the Act, effective October 1, 1984, imposes a tax on the sale of any sport fishing equipment by the manufacturer, producer, or importer.

Section 4162(a) of the Code, as added by section 1015(b) of the Act, effective October 1, 1984, defines the term "sport fishing equipment" to include fishing tip-ups and tilts and articles of terminal tackle, including artificial lures. This definition expanded the types of fishing equipment previously subject to the tax imposed by section 4161(a).

HOLDING

Accordingly, effective October 1, 1984, sales by the manufacturer, producer, or importer of the ice fishing tip-ups described in Rev. Rul. 78-108, including the spool, are subject to the tax imposed by section 4161(a)(1) of the Code. The spear fishing decoy remains taxable as an artificial lure.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 78-108 is modified and, as modified, is superseded, effective October 1, 1984.

Section 4162.—Definitions; Treatment of Certain Resales

Whether certain articles of sport fishing equipment are subject to the tax imposed by section 4161(a)(1) of the Code. See Rev. Rul. 85-149, page 260.

Whether certain articles of sport fishing equip-

ment are subject to the tax imposed by section 4161(a)(1) of the Code. See Rev. Rul. 85-150, page 260.

Whether certain articles of sport fishing equipment are subject to the tax imposed by section 4161(a)(1) of the Code. See Rev. Rul. 85-151, page 260.

Whether certain articles of sport fishing equipment are subject to the tax imposed by section 4161(a)(1) of the Code. See Rev. Rul. 85-152, page 261.

Whether certain articles of sport fishing equipment are subject to the tax imposed by section 4161(a)(1) of the Code. See Rev. Rul. 85-153, page 262.

Part III.—Firearms

Section 4181.—Imposition of Tax

26 CFR 48.4181-2: Meaning of terms.

The meaning of the terms "shells" and "cartridges" for purposes of the tax imposed on firearms. See T.D. 8043, page 214.

Section 4182.—Exemptions

26 CFR 48.4182-1: Exempt sales.

Tax-exempt sales of firearms to the Defense Department of the U.S. Coast Guard. See T.D. 8043, page 214.

Subchapter F.—Special Provisions Applicable to Manufacturers Tax

Section 4217.—Leases

26 CFR 48.4217-1: Lease considered as sale.

Tax treatment of a lease of an automobile subject to gas guzzler tax. See T.D. 8036, page 208.

Chapter 36.—Certain Other Excise Taxes
Subchapter D.—Tax on Use of Certain Vehicles

Section 4481.—Imposition of Tax

26 CFR 41.4481-1: Imposition of tax. (Also Sections 4482, 4483, 6001, 6427; 41.4482(b)-1, 41.4483-3, 41.6001-1, 48.6427-6.)

T.D. 8027

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, SUBCHAPTER H, PART 41—EXCISE TAX ON USE OF CERTAIN HIGHWAY MOTOR VEHICLES; PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES; PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Heavy Vehicle Use Tax; Credits and Refunds of the Tax on the Sale of Diesel Fuel.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the imposition of the tax on the use of heavy vehicles and relating to credits and refunds of the tax imposed on the sale of diesel fuel. Changes to the applicable tax law regarding heavy vehicles were made by the Surface Transportation Assistance Act of 1982 [Pub. L. 97-424, 1983-1 C.B. 405] and the Tax Reform Act of 1984 [1984-3 C.B. (Vol. 1) 1]. Changes to the applicable tax law regarding credits and refunds of the diesel fuel tax were made by the Tax Reform Act of 1984. The regulations would affect owners of highway motor vehicles, State motor vehicle administrations, and users of diesel fuel and would provide them with the guidance needed to comply with those Acts.

DATES: Except as otherwise provided in this document, the amendments to the regulations are effective after June 30, 1984.

FOR FURTHER INFORMATION CONTACT: William A. Jackson of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T LR-31-83, (202-566-4336), not a toll free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On November 6, 1984, the FEDERAL REGISTER published proposed amendments to the Excise Tax Regulations (26 CFR Part 41) under sections 4481, 4482, and 4483 of the Internal Revenue Code of 1954 (Code) (49 FR 44300) [LR-31-83, 1984-2 C.B. 868]. These amendments were proposed to conform the regulations to section 513 of the Highway Revenue Act of 1982 (Title V of the Surface Transportation Assistance Act of 1982) (P.L. 97-424, 96 Stat. 2177) [1983-1 C.B. 405, 409] and sections 901, 902, and 903 of the Tax Reform Act of 1984 (Division A of the Deficit Reduction Act of 1984) (P.L. 98-369, 98 Stat. 1003) [1984-3 C.B. (Vol. 1) 1, 511] and are to be issued under the authority contained in sections 4482(b) (70 Stat. 390, 26 U.S.C. 4482(b)), 4483(d) (96 Stat. 2178, 26 U.S.C. 4483(d)), and 7805 (68A Stat. 917, 26 U.S.C. 7805) of the Code. That document also provided proposed amendments to the Excise Tax Regulations (26 CFR Part 41) to conform the regulations to section 143(a) of the Surface Transportation Assistance Act of 1982. Those amendments to the regulations were proposed to provide guidance regarding the proof of payment of the Federal heavy vehicle use tax that a State is required to receive as a condition for issuing a registration for a vehicle. In addition, that document contained proposed amendments to the Excise Tax Regulations (26 CFR Part 48) under section 6427(b)(2) of the Code relating to an exemption from the tax imposed by section 4041 of the Code in the case of fuel used in certain buses, and under section 6427(g) of the Code relating to an income tax credit or refund for original purchasers of diesel-powered automobiles and light trucks. These last two amendments were proposed to conform the regulations to sections 911(b), and 915 of the Tax Reform Act of 1984, respectively. A public hearing was held on December 14, 1984. After consideration of all comments regarding the proposed regulations, the amendments are adopted as revised by this Treasury decision.

SUMMARY OF REVISIONS

Canadian Vehicles
Used in the United States

The proposed regulations provided that the Federal heavy vehicle use tax is imposed on any highway motor vehicle that is registered in a Canadian province and is also proportionally registered in the United States under the International Registration Plan (IRP). Several commentators suggested that the imposition of the tax on Canadian vehicles should be suspended pending the completion of the trans-border trucking study by the Department of Transportation. This study was ordered by section 932 of the Tax Reform Act to study the significance of the heavy vehicle use tax on trans-border trucking

operations. The regulations have been revised to provide that for taxable periods beginning after June 30, 1985, a vehicle that is issued a "base plate" by a Canadian province will not be subject to the tax merely because it is proportionally registered in the United States under the IRP or similar agreement and is used on the public highways in the United States. Accordingly, Rev. Rul. 81-86 (1981-1 C.B. 504), which held that such vehicles are liable for the tax, will be revoked.

Taxable Gross Weight

Section 41.4482(b)-1(e) of the proposed regulations provided that the taxable gross weight of a highway motor vehicle shall be the highest gross weight at which the vehicle is registered in any State during the taxable period. Under the proposed regulations, if a vehicle were registered only in a state or states that register vehicles on the basis of the unladen weight of the vehicle, the taxpayer would declare the taxable gross weight of the vehicle based on its gross operating weight. Several commentators pointed out that certain states that register vehicles on the basis of gross weight have large registered weight brackets and the highest registered weight of a vehicle may be several thousand pounds higher than the actual gross weight declared for the vehicle for purposes of registration. This would have made it possible for two identical vehicles having the same declared gross weight to have different taxable gross weights in different states depending on the size of each state's registered weight brackets.

Under the final regulations, the taxable gross weight of a highway motor vehicle is the weight which is declared by the taxpayer on the basis of the definition of taxable gross weight in §41.4482(b)-1(a) regardless of whether or not the States in which the vehicle is registered register vehicles on the basis of the vehicle's unladen weight. Such declaration of taxable gross weight must be no less than the highest specific gross weight of the vehicle declared by the registrant at any time during the taxable period for any purpose including the registration of the vehicle in any State or the payment of any other fees or taxes. If no declaration by the registrant of a specific gross weight amount is required with respect to a vehicle, then the taxable gross weight must fall within the highest gross weight registration category for which such vehicle is registered if the vehicle is registered in any state that registers vehicles on the basis of gross weight.

Trucks Used in Logging

The final regulations clarify the requirement under §41.4483-6(b) that a vehicle must be registered as a highway motor vehicle used exclusively in the transportation of harvested forest products under the laws of the State where such vehicle is required to be registered in order to qualify for a 25 percent reduction in the heavy vehicle use tax. This clarification states that if a vehicle is registered as a vehicle used in the transportation of harvested forest products under a State statute or legally valid regulations then such vehicle will be considered to be so registered under the laws of the State. In addition, the final regulations clarify that no special license plate or tag identifying a vehicle as being used in the transportation of harvested forest products is required. The final regulations also clarify a similar State registration requirement under §41.4483-3(g)(1) regarding the 7,500 mile exemption for agricultural vehicles.

Proof of Payment

Section 41.6001-2 of the proposed regulations has been substantially revised in response to the many comments received regarding the proof of payment requirements. This section of the proposed regulations implemented section 143(a) of the Surface Transportation Assistance Act of 1982, which provided that a State must receive proof of payment of the Federal heavy vehicle use tax as a condition of registering a highway motor vehicle subject to the tax. Failure to require such proof of payment shall result in a reduction of that State's Federal-aid highway funds. In order to allow the State governments sufficient time to comply with the proof of payment requirements, the final regulations provide that the States will not be required to receive proof of payment as a condition of vehicle registration until October 1, 1985.

The final regulations under §41.6001-2(b)(1) provide generally that a State to which an application is made to register a highway motor vehicle must receive from the registrant proof of payment of the heavy vehicle use tax. Such proof of payment must be received by a "base state" when issuing an "apportioned plate" under the International Registration Plan (IRP) (or similar agreement) for a highway motor vehicle, but no proof of payment is required to be presented to the other states for which the vehicle is proportionally registered and which are listed on the IRP cab card issued by the base state. Further, no proof of payment is required to be received by a State with respect to the issuance of certain special temporary travel permits.

In the case of a State that registers vehicles on the basis of gross vehicle weight, §41.6001-2(b)(2)(i) of the final regulations provides that proof of payment is required to be received by such State with respect to any highway motor vehicle that has a declared gross weight in that State of 55,000 pounds or more. No proof of payment is required for any vehicle that has a declared gross weight in that State of less than 55,000 pounds. If no declaration of a specific gross weight is made with respect to a vehicle registered on the basis of gross weight, then the State must require proof of payment with respect to such vehicle if the minimum weight of the registered weight category for such vehicle is 55,000 pounds or more. In the case of a State that registers vehicles other than on the basis of gross vehicle weight, §41.6001-2(b)(2)(ii) of the final regulations provides that such State may register a highway motor vehicle without receiving proof of payment with respect to such vehicle if the State receives a written statement stating that during the taxable period which includes the date on which the State receives the application for registration, such vehicle had a taxable gross weight of less than 55,000 pounds. In addition, such State may register a highway motor vehicle without receiving either proof of payment or a written statement if such vehicle has an unladen weight of 8,000 pounds or less.

Generally, the final regulations provide that proof of payment with respect to a highway motor vehicle must be received by a State before such State is-

sues a registration for such vehicle. However, §41.6001-2(b)(3) of the final regulations is designed to allow States with computerized registration systems to implement a "suspension" registration system. Under the system provided in the final regulations, a State may register taxable highway motor vehicles without receiving proof of payment at the time the application for registration is received. Registration under a suspension system must be on the condition that the State receive proof of payment with respect to a taxable vehicle no later than 4 months after the beginning of the registration period. If the State does not receive the proof of payment within the required time then the State must suspend the registration of such vehicle until such time as proof of payment is received.

Section 41.6001-2(b)(6) of the final regulations provides that a description of the supporting documentation and records required by the Federal Highway Administration to verify compliance by the states of the proof of payment requirements is set forth in 23 CFR Part 669. The proposed regulations had provided that the States were not required to retain records of having received proof of payment. However, a lack of such records will make it difficult for the Federal Highway Administration to verify compliance by the States of the proof of payment requirements. For this reason, the final regulations have been revised to allow the Federal Highway Administration to prescribe rules stating what records it will require for its verification procedures.

The final regulations provide that in general, the vehicle identification numbers of the vehicles sought to be registered must appear on the proof of payment received by the State. However, §41.6001-2(c)(1)(ii) of the final regulations provides that if a receipted Schedule 1 is submitted as proof of payment for registering one or more highway motor vehicles and the total of the number of vehicles on such Schedule 1 for which the tax has not been suspended under §41.4483-3 exceeds 21 and the name of the taxpayer on such Schedule 1 is one of the names in which such vehicles are sought to be registered, then such Schedule 1 shall be accepted as proof of payment in support of the registration of a number of vehicles equal to or less than such total, and a list of the vehicle identification numbers is not required as part of the proof of payment. The same rule applies if the total of the number of vehicles on the Schedule 1 for which tax is suspended under §41.4483-3 exceeds 9. If a receipted Schedule 1 does not include a list of vehicles for which tax is being reported and the name of the taxpayer on such Schedule 1 is not one of the names in which a vehicle is sought to be registered, then such Schedule 1 may be accepted as proof of payment with respect to such vehicle if it is accompanied by a written statement executed by the taxpayer containing the vehicle identification number of the vehicle sought to be registered and a statement that the tax was paid on such vehicle.

Finally, the final regulations regarding proof of payment do not require a State to verify the correctness of the taxable gross weights for vehicles listed on the proof of payment. The proposed regulations had provided that proof of payment received by a State on or after September 1, 1985 (other than a Schedule 1 on which the vehicles are not required to be listed), shall only serve as valid proof of payment for a vehicle whose vehicle identification number appears on the Schedule 1 and which is being registered at a weight equal to or less than the taxable gross weight listed on the Schedule 1 for such vehicle. The requirement that such vehicle not be registered at a weight which is higher than the taxable gross weight shown on the Schedule 1 is deleted from the final regulations.

Computer Tape Proof of Payment Verification

Several commentators suggested that the states be allowed to satisfy the proof of payment requirement through the exchange of computer tape between the State and the Internal Revenue Service. Although no system of this type is provided for in these final regulations, the Internal Revenue Service is continuing to actively consider the implementation of a computer tape proof of payment system. Such a system, and the procedures for complying with it, would be provided by Revenue Procedure.

PAPERWORK REDUCTION ACT

The collection of information requirements contained in these final regulations have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. These regulations have been approved by OMB (control number 1545-0143).

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required. Although a notice of proposed rulemaking that solicited public comment was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 did not apply. Accordingly, the final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6)

DRAFTING INFORMATION

The principal author of these regulations is William A. Jackson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 41, 48, and 602 are amended as follows:

Part 41—[Amended]

Paragraph 1. The authority citation for Part 41 is revised to read as follows:

Authority: 26 U.S.C. 7805; §41.4482(b)-1 also issued under 26 U.S.C. 4482(b); §41.4483-3 also issued under 26 U.S.C. 4483(d).

Par. 2. Section 41.4481-1 is revised to read as set forth below:

§41.4481-1 Imposition of tax.

(a) *In general* (1) A tax is imposed under section 4481(a) of the Code for each taxable period beginning after June 30, 1984, on the first use on the public highways in the United States during such period of any highway motor vehicle that (together with the semitrailers and trailers customarily used in connection with highway motor vehicles of the same type as such highway motor vehicle) has a taxable gross weight of at least 55,000 pounds, at the rate specified in paragraph (b) of this section. The tax is imposed on the use of such a highway motor vehicle only if, at the time of the use of such vehicle, it is registered or required to be registered in the name of a person (whether or not such person is the person who uses the vehicle). See, however, §§41.4483-1, 41.4483-2, and 41.4483-3 relating, respectively, to exemptions from the tax in the case of highway motor vehicles used by a state or any political subdivision thereof, certain transit-type buses, and vehicles used for 5,000 or fewer miles (7,500 or fewer miles in the case of agricultural vehicles) on public highways. See §41.4483-6 relating to a reduction in tax in the case of certain trucks used in logging. For definitions of the terms "registered", "highway motor vehicle", "taxable gross weight", "taxable period", "use", and "customary use", see §§41.4481-4, 41.4482(a)-1, 41.4482(b)-1, and paragraphs (b), (c), and (d) of §41.4482(c)-1 respectively.

(2) For taxable periods beginning after June 30, 1985, any highway motor vehicle that is issued a base plate by a Canadian province under the International Registration Plan (IRP) or similar agreement and has a proportional registration under such agreement to satisfy the registration laws of any of the United States shall be exempt from the tax imposed by section 4481(a).

(b) *Rate of tax.* (1) For taxable periods after June 30, 1956, and before July 1, 1984, the tax is computed on each 1,000 pounds of taxable gross weight or fraction thereof for each highway motor vehicle the use of which at any time during the taxable period is subject to the tax. Thus, any fraction of 1,000 pounds of taxable gross weight is treated as 1,000 pounds for purposes of the computation of the tax. Following are the rates of tax in effect for taxable periods after June 30, 1956, and before July 1, 1984:

Period of vehicle use	Rate of tax per 1,000 pounds or fraction thereof of taxable gross weight
For each taxable year period commencing after June 30, 1956, and ending before July 1, 1961	$1.50
For each taxable year period commencing after June 30, 1961, and ending before July 1, 1984	3.00

(2) For taxable periods after June 30, 1984, the tax is computed on each 1,000 pounds of taxable gross weight or fraction thereof of each highway motor vehicle the use of which at any time during the taxable period is subject to the tax as set forth in paragraph (a)(1) of this section. Thus, any fraction of 1,000 pounds of taxable gross weight in excess of 55,000 pounds of taxable gross weight is treated as 1,000 pounds for purposes of the computation of the tax. Following are the rates of tax in effect for taxable periods after June 30, 1984:

Taxable gross weight	Rate of tax
At least 55,000 pounds but not over 75,000.	$100 per taxable period plus $22 for each 1,000 pounds (or fraction thereof) in excess of 55,000 pounds.
Over 75,000 pounds	$550.

For the taxable period beginning July 1, 1988, and ending September 30, 1988, the annual rate of tax shall be determined by substituting "$25" for "$100", "$5.50" for "$22", and "$137.50" for "$550", in the table in this paragraph (b)(2). However, if the tax imposed by section 4481(a) is extended to apply to use after September 30, 1988, the rate of tax for taxable periods after June 30, 1988, shall be as provided in section 4481(a).

(c) *Computation of tax.* (1) Except as provided in paragraph (c)(2) of this section, the tax on the use of a particular highway motor vehicle for taxable periods beginning after June 30, 1984, is computed as follows:

(i) For vehicles with a taxable gross weight of at least 55,000 pounds, but not over 75,000 pounds, add to $100 an amount equal to $22 for each 1,000 pounds (or fraction thereof) in excess of 55,000 pounds; and

(ii) For vehicles with a taxable gross weight over 75,000 pounds, the tax is $550.

(2) If the first taxable use of a particular highway motor vehicle is made after the first month of the taxable period, the tax on the use of such vehicle for such taxable period is computed by multiplying the amount of tax that would be due for a full taxable period as computed under paragraph (c)(1) of this section, by a fraction. Such fraction shall have as its numerator the number of months in the taxable period beginning with the month of first taxable use and as its denominator the number of months in the entire taxable period. For purposes of determining the fraction, any part of a month is counted as a full month. (See example (2) of paragraph (e) of this section.)

(3) If a Form 2290 has been filed for a taxable period for a highway motor vehicle based on a particular taxable gross weight, and such taxable gross weight increases during the same taxable period, then the taxpayer shall file a new Form 2290 and pay (either in full or by installments) any additional tax imposed as a result of the increased taxable gross weight. Such additional tax shall be equal to the amount calculated according to the following formula:

$$\left[\left(T_1 \times \frac{P}{12}\right) + \left(T_2 \times \frac{R}{12}\right)\right] - T_1$$

where:

- T_1 = Tax imposed for a full taxable period (or partial taxable period as determined under paragraph (c)(2) of this section) at the vehicle's previously reported taxable gross weight.
- T_2 = Tax imposed for the same taxable period as used in T_1 at the vehicle's increased taxable gross weight.
- P = The number of months in the taxable period during which the vehicle's taxable gross weight was as previously reported for such taxable period. This number does not include the month in which the vehicle's taxable gross weight increased.
- R = The number of months remaining in the taxable period including the month in which the vehicle's taxable gross weight was increased.

If tax was imposed for a partial taxable period as determined under paragraph (c)(2) of this section, the additional tax is determined by substituting the number of months in such partial taxable period for "12" in the above formula.

(4) If an any taxable period the taxable gross weight of a highway motor vehicle is decreased, the computation of tax is not affected and no right to credit or refund of any tax paid under section 4481 arises.

(5) If in any taxable period a highway motor vehicle is destroyed or stolen before the first day of the last month in the taxable period, and is not subsequently used during such taxable period, the tax shall be calculated proportionately from the first day of the month in the period in which the first taxable use of the highway motor vehicle occurs to and including the last day of the month in which the highway motor vehicle was destroyed or stolen. Any tax paid under section 4481(a) on such a highway motor vehicle in excess of the tax calculated in the preceding sentence, shall be an overpayment for which a credit or refund of tax may be claimed. For purposes of this paragraph (c)(5), a highway motor vehicle is destroyed if the vehicle is damaged due to an accident or other casualty to such an extent that it is not economical to rebuild.

(6) If the use of a highway motor vehicle during the taxable period is discontinued (for reasons other than destruction or theft as described in paragraph (c)(5) of this section) or is converted to a use which is exempt from the tax imposed by section 4481(a), the computation of the tax is not affected and no right to a credit or refund of any tax paid under section 4481 arises.

(d) *Credit or refund of tax under section 4481(a).* (1) Any claim for refund of an overpayment of tax under section 4481(a) due to destruction or theft of the vehicle shall be made in accordance with the applicable provisions of this section and §301.6402-2 (Regulations on Procedure and Administration) and shall be filed by the person in whose name the vehicle is registered or required to be registered when the vehicle is destroyed or stolen A claim for refund of the tax imposed by section 4481(a) is to be filed on Form 843 (Claim).

(2) Any person entitled to claim a refund of tax under paragraph (d)(1) of this section may, in lieu of claiming a refund of such tax, claim a credit for such tax on the next Form 2290 required to be filed.

(e) *Examples.* The application of this section may be illustrated by the following examples:

Example (1). In the taxable period beginning July 1, 1984, the first taxable use of a particular highway motor vehicle, a bus, having a taxable gross weight of 56,000 pounds, occurs on July 10, 1984, at which time the vehicle is registered in the name of X. A tax of $122 ($100 + $22) is imposed on X for the use of such vehicle for such taxable period.

Example (2). On July 1, 1984, X has registered in his name a highway motor vehicle having a taxable gross weight of 60,000 pounds. The vehicle is in "dead storage" until August 10, 1984, at which time X starts using the vehicle on the public highways in carrying on his trucking business. On August 10, 1984, the vehicle is still registered in X's name. Since the first taxable use of this highway motor vehicle during the taxable period occurred on August 10, 1984, X is required to pay a tax of $192.50 ([$100 + (5 × $22)] × 11/12) for such taxable period.

Example (3). On April 15, 1985, a vehicle with a taxable gross weight of 70,000 pounds and registered in the name of Y is completely destroyed. Y had purchased the vehicle from X who had paid the tax for the taxable period beginning July 1, 1984. Y is entitled to a refund of tax for those full months after destruction in the taxable period ending June 30, 1985. Thus, Y may file a claim for a refund of $71.67 − 2/12 of the total tax of $430 ($100 + (15 × $22)).

Par. 3. Section 41.4481-1T is removed.

Par. 4. Section 41.4481-1aT is redesignated as §41.4481-1T.

Par. 5. Section 41.4481-2 is amended as follows:

(a) Paragraph (a)(2) and the example contained therein are revised to read as set forth below.

(b) The material following the first sentence of paragraph (b) is revised to read as set forth below.

§41.4481-2 Persons liable for tax.

(a) * * *

(2) The application of paragraph (a)(1) of this section may be illustrated by the following example:

Example. In the taxable period beginning July 1, 1985, the first taxable use of a particular highway motor vehicle having a taxable gross weight of 60,000 pounds occurs on July 10, 1985, at which time the vehicle is registered in the name of Y. On September 1, 1985, Y sells the vehicle to X who registers and uses the vehicle before the end of such taxable period. Since the vehicle was registered in the name of Y at the time of its first taxable use, Y is liable for the total tax of $210 ($100 + (5 × $22)) imposed on the use of the vehicle for the taxable period. X is also liable for $210 tax or any part thereof, but only to the extent that Y does not pay it. To the extent that either X or Y pays the tax the other party is relieved of such liability.

(b) * * * Such person shall also obtain and keep as evidence a statement from the transferor as to whether there was in effect, at the time the vehicle was acquired, a suspension under §41.4483-3(a) of the tax imposed by section 4481(a). The evidence may take the form of a written statement, signed and dated by the person from whom the vehicle was acquired, showing whether there was or was not a prior taxable use of the vehicle and whether there was a suspension of tax in the taxable period. If the vehicle is acquired from a dealer in highway motor vehicles, the statement may be obtained from such dealer or from the person from whom the dealer acquired such vehicle. If evidence is not obtained showing whether there was or was not a prior taxable use of such vehicle and whether there was a suspension of tax in the taxable period, such person shall keep as a part of his records a written statement of the reason why he was unable to obtain such evidence.

* * * * *

Par. 6. Section 41.4482(b)-1 is amended as follows:

(a) Paragraph (a) is revised to read as set forth below.

(b) Paragraph (d) is amended by revising the heading to read as set forth below and by substituting "after June 30, 1969, and before July 1, 1984" for "beginning on or after July 1, 1969", at the end of the first sentence.

(c) New paragraphs (e) and (f) are aided to read as set forth below.

§41.4482(b)-1. Definition of taxable gross weight.

(a) *In general.* The tax imposed on the use of a highway motor vehicle (of a taxable gross weight of at least 55,000 pounds) is based on the taxable gross weight of such highway motor vehicle. Taxable gross weight of a highway motor vehicle is determined with reference to the sum of (1) the actual unloaded weight of such highway motor vehicle (fully equipped for serv-

ice); (2) the actual unloaded weight of any trailers or semitrailers (fully equipped for service) customarily used in combination with such highway motor vehicle; and (3) the weight of the maximum load customarily carried on such highway motor vehicle and on any trailers or semitrailers customarily used in combination with such highway motor vehicle. In order to determine the taxable gross weight of a particular vehicle for a particular taxable period, use the appropriate method described in either paragraphs (c), (d), or (e) of this section or §41.4482(b)-1T.

* * * * *

(d) *Schedule of taxable gross weights for taxable periods beginning after June 30, 1969, and ending before July 1, 1984.* * * *

(e) *Determination of taxable gross weight for taxable periods after June 30, 1985*—(1) *In general.* For purposes of the tax imposed by section 4481(a), the taxable gross weight of a highway motor vehicle shall be equal to the sum of the weights referred to in paragraph (a) of this section. The taxable gross weight of a highway motor vehicle shall be reported by the taxpayer on Form 2290 for any vehicle that has a taxable gross weight of 55,000 pounds or more. In the case of a highway motor vehicle that is registered in at least one State that requires a declaration of gross weight to be stated as a specific amount for any purpose (including proportional or prorate registration or the payment of any other fees or taxes), the taxable gross weight of such vehicle must be no less than the highest gross weight declaration (or combined gross weight declaration in the case of a tractor-trailer or truck-trailer combination) made by the registrant in any State with respect to such vehicle. If a highway motor vehicle is registered in at least one State that requires vehicles to register on the basis of gross weight and such vehicle is not registered in any State that requires a declaration of gross weight to be stated as a specific amount by the registrant, the taxable gross weight of such vehicle must fall within the highest gross weight category of such State for which such vehicle is registered during the taxable period.

Declarations of weight made in order to obtain special temporary travel permits which allow a vehicle to, (i) operate in a State in which the vehicle is not registered or prorated, (ii) operate at more than a State's maximum statutory weight limit, or (iii) operate at more than the weight that the vehicle is registered in a State, shall not be considered in determining the taxable gross weight of a vehicle.

(2) *Buses.* For purposes of the tax imposed by section 4481(a), the taxable gross weight of a bus shall be the sum of the weights referred to in paragraph (a) of this section except that "the weight of the maximum load customarily carried" on a bus shall be equal to 150 pounds times the number of units of seating capacity provided for passengers and driver.

(f) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). A is the owner of a truck-tractor. On January 1, 1985, A registers the truck-tractor in three states—X, Y, and Z. For purposes of registering the vehicle in State X, A declares the gross operating weight of his truck-tractor to be 60,000 pounds. The declaration of the gross weight of the vehicle at 60,000 pounds places A's truck-tractor in the State X registration category of 55,000 to 62,000 pounds gross weight. Thus, the registered weight of A's vehicle in State X is 62,000 pounds. At the same time as A registers the vehicle in State X, A also proportionally registers the vehicle under the IRP in State Y. A uses the same declared gross weight of 60,000 pounds for purposes of the State Y proportional registration. Registration in State Y at this declared gross weight places A's truck-tractor in the State Y gross weight registration category of 58,000 to 68,000 pounds. Finally, A registers the truck-tractor in State Z. Registration of vehicles in State Z is based on the unladen weight of the vehicle. During the taxable period beginning on July 1, 1985, A's truck-tractor is not registered in any other state. For the taxable period beginning on July 1, 1985, A must declare a taxable gross weight of no less than 60,000 pounds for purposes of the tax imposed by section 4481(a) because that is the highest declared gross weight for state registration or other purposes. Should A declare to any State agency a higher gross operating weight with respect to the truck-tractor during the same taxable period (except for a special temporary permit), A would then be liable for additional tax as determined under paragraph (c)(3) of §41.4481-1.

Example (2). Assume the same facts as in example (1), except that on one occasion during the taxable period, A was issued a special 2-day permit to use his truck-tractor in State Y to haul a load which would give A's unit a total gross weight of 80,000 pounds. A may still declare the taxable gross weight of his unit to be no less than 60,000 pounds because special permits to haul heavier loads on a temporary basis are not considered in determining the taxable gross weight of a vehicle.

Example (3). C owns and has registered in his name 2 trucks which are identical in all respects and which are used to carry the same type of load. The first vehicle is registered only in State X at a registered weight of 73,000 pounds based on a declared gross weight of 70,000 pounds. The second vehicle is registered only in State Y at a registered weight of 68,000 pounds based on a declared gross weight of 65,000 pounds. No other declarations of gross weight are made with respect to either vehicle. For purposes of the Federal heavy vehicle use tax, the taxable gross weight of the vehicles registered in State X may be declared at no less than 70,000 pounds and the taxable gross weight of the vehicle registered in State Y may be declared at no less than 65,000 pounds even though the vehicles are identical.

Par. 7. Section 41.4482(c)-1 is amended by substituting "1988" for "1979" every place it appears in paragraph (b) and by adding a new paragraph (d) immediatey after paragraph (c) to read as set forth below:

§41.4482(c)-1 Definition of State, taxable period, use and customary use.

* * * * *

(d) *Customary use.* For taxable periods beginning after June 30, 1984, the term "customary use" as used in the regulations in this part, means that a semitrailer or trailer shall be treated as customarily used in connection with a highway motor vehicle if the vehicle is equipped to tow such semitrailer or trailer.

Par. 8. Examples (1), (2), and (3) of §41.4483-2(f) are amended by substituting "1984" for "1962" wherever it appears, by substituting "1985" for "1963" wherever it appears, by substituting the phrase "at least 55,000 pounds" for "more than 26,000 pounds" wherever it appears, and by substituting the phrase "less than 55,000 pounds" for "26,000 pounds or less" wherever it appears.

Par. 9. Section 41.4483-2T is removed.

Par. 10. Section 41.4483-3 is redesignated as §41.4483-4, §41.4483-3T is removed and a new §41.4483-3 is inserted immediately after §41.4483-2 to read as set forth below:

§41.4483-3 Exemption for trucks used for 5,000 or fewer miles and agricultural vehicles used for 7,500 or fewer miles on public highways.

(a) *Suspension of tax.*—(1) *In general.* Liability for the tax imposed by

section 4481(a) is suspended during a taxable period if it is reasonable to expect that the vehicle will be used for 5,000 or fewer miles on public highways during such taxable period and the owner furnishes in the time and manner required the information required under paragraph (a)(2) of this section. See paragraph (g) of this section regarding special rules for agricultural vehicles. See §41.4482(c)-1(c) for the meaning of "use" on the public highways.

(2) *Information to be supplied in support of suspension of tax.* The owner of a highway motor vehicle who reasonably expects that the vehicle will be used for 5,000 or fewer miles on public highways during a taxable period shall furnish on the first Form 2290 (Heavy Vehicle Use Tax Return) filed during the taxable period for such motor vehicle, such information as is required by the Form in order to support the suspension of tax under paragraph (a) of this section.

(b) *Cessation of suspension from tax.* If a highway motor vehicle on which the tax under section 4481(a) is suspended for a particular taxable period under paragraph (a)(1) of this section is used for more than 5,000 miles on public highways during such taxable period, the owner of the vehicle shall pay the tax for the entire taxable period in accordance with section 4481(a). The tax shall be reported on a Form 2290, which must be filed on or before the last day of the month immediately following the month in which the use of the vehicle during the taxable period exceeds 5,000 miles. If such Form is filed within the time required by the preceding sentence, it shall be treated as timely filed.

(c) *Exemption.* If at the end of any taxable period during which the tax under section 4481(a) on a highway motor vehicle was suspended under paragraph (a)(1) of this section the vehicle has not been used for more than 5,000 miles on public highways, the vehicle shall be exempt from the tax for that taxable period. The owner of the vehicle shall verify that the vehicle was used for less than 5,000 miles in such ended taxable period on the first Form 2290 filed for the next taxable period.

(d) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). A is the owner of 6 highway motor vehicles, each of which has a taxable gross weight in excess of 55,000 pounds. None of these 6 vehicles are agricultural vehicles. The vehicles are placed in use during July 1984. Because of the nature of his business, A reports on the first Form 2290 filed after June 30, 1984, that he reasonably expects that none of the vehicles will be used for more than 5,000 miles on public highways. Accordingly, the tax imposed by section 4481(a) is suspended for A's 6 vehicles for the taxable period July 1, 1984, through June 30, 1985.

Example (2). Assume the same facts as in example (1) except that during the month of February 1985, the use of one of A's vehicles exceeds 5,000 miles on public highways. A is liable for the full tax for the taxable period July 1, 1984, through June 30, 1985, for that vehicle at the rate set forth in §41.4481-1(b), and must so report on a Form 2290 filed on or before March 31, 1985, the last day of the month following the month in which the use exceeds 5,000 miles.

(e) *Credit or refund of tax for highway motor vehicle used 5,000 or fewer miles.* (1) If a highway motor vehicle on which the tax imposed by section 4481(a) has been paid for a given taxable period is used for 5,000 or fewer miles on public highways during such taxable period, the person who paid the tax may file a claim for refund of an overpayment of the tax at the end of the taxable period. Claims for refunds of tax made under this paragraph (e) shall be filed in the same manner as claims for refunds filed under §41.4481-1(d). Refunds of tax made under this paragraph (e) shall be without interest.

(2) Any person entitled to claim a refund of tax under paragraph (e)(1) of this section may, in lieu of claiming a refund of such tax, claim credit for such tax on the first Form 2290 filed for the next taxable period.

(f) *Relief from liability for tax under certain circumstances.* If the tax imposed by section 4481(a) on a highway motor vehicle is suspended for any taxable period under paragraph (a) of this section and the vehicle is transferred while the suspension is in effect, the transferor will not be liable for any tax on such vehicle for such taxable period if such transferor furnishes a statement to the transferee on name, address and taxpayer identification number, the vehicle identification number, the date of transfer of the vehicle, the number of miles the vehicle has been used on the public highways during the taxable period, the odometer reading at the time of the transfer, and the name, address and taxpayer identification number of the transferee. The statement required in the preceding sentence shall be attached by the transferee to a Form 2290 which must be filed on or before the last day of the month following the month in which such vehicle is transferred. The suspension from tax under paragraph (a) continues until the vehicle is used on the public highways for more than 5,000 miles during the taxable period (including use by the transferor for the portion of the taxable period prior to the transfer). If the transferor has furnished the statement required in this paragraph (f), the transferee and not the transferor is liable for the entire tax under section 4481(a) for the taxable period in which the transfer was made. If the transferor has not furnished such statement to the transferee, then the transferor is also liable for the tax on the use of such vehicle for such taxable period to the extent that the tax or an installment payment of the tax has not been previously paid. See paragraph (b) of this section relating to cessation of suspension from tax.

(g) *Special rule for agricultural vehicles*—(1) *In General.* In applying the provisions of this section to an agricultural vehicle, "7,500" shall be substituted for "5,000" each place it appears in paragraphs (a) through (f) of this section.

(2) *Meaning of terms*—(i) *Agriculture vehicle.* An agricultural vehicle is any highway motor vehicle—

(A) Used (or expected to be used) primarily for farming purposes, and

(B) Registered (under the laws of the State or States in which such vehicle is required to be registered) as a highway motor vehicle used for farming purposes.

A highway motor vehicle is used primarily for farming purposes if more than one-half of such vehicle's use (determined on the basis of mileage) during the taxable period is for farming purposes. Further, the highway motor vehicle must be registered (under the laws of the State or States where such vehicle is required to be registered) as a highway motor vehicle used for farming purposes for the entire taxable period in order to qualify as an agricultural vehicle. See §41.4482(a)-(1) for the definition of "highway motor vehi-

cle". A vehicle will be considered to be registered under the laws of the State as a highway motor vehicle used for farming purposes if such vehicle is so registered under a state statute or legally valid regulations. In addition, no special tag or license plate identifying a vehicle as being used for farming purposes is required.

(ii) *Farming purposes.* For purposes of this section, "farming purposes" means the transporting of any farm commodity to or from a farm, or the use directly in agricultural production.

(iii) *Farm commodity.* A "farm commodity" is any agricultural or horticultural commodity, feed, seed, fertilizer, livestock, bees, poultry, fur-bearing animals, or wildlife. A farm commodity does not include a commodity which has been changed by a processing operation from its raw or natural state. For example, juice which has been extracted from fruits or vegetables is not a farm commodity for purposes of this paragraph (g).

(iv) *Farm.* The term "farm" includes stock (including feed yards for fattening cattle), dairy, poultry, fruit, fur-bearing animal, and truck farms, plantations, ranches, nurseries, ranges, orchards, and such greenhouses and other similar structures as are used primarily for the raising of any agricultural or horticultural commodity. Greenhouses and other similar structures used primarily for purposes other than the raising of agricultural or horticultural commodities (for example, display, storage, or fabrication of wreaths, corsages, and bouquets) do not constitute "farms".

(v) *Agricultural production*—(A) *In general.* A highway motor vehicle is considered to be used directly in agricultural production only if it is used as indicated in the following paragraphs.

(B) *Use of a highway motor vehicle in connection with cultivating, raising, and harvesting.* A highway motor vehicle is considered to be used directly in agricultural production if such vehicle is used in connection with cultivating the soil, or raising or harvesting any agricultural or horticultural commodity, including the raising, shearing, feeding, caring for, training and management of livestock, bees, poultry, and fur-bearing animals and wildlife. A highway motor vehicle which is used in connection with operations such as canning, freezing, packaging, or other processing operations will not be considered to be used directly in agricultural production.

(C) *Use of a highway motor vehicle in connection with planting, cultivation, caring for, cutting, etc. of trees.* A highway motor vehicle is used directly for agricultural production if it is used in connection with planting, cultivating, caring for, or cutting of trees, or in connection with the preparation (other than milling) of trees for market; but only if such operations are incidental to farming operations. These farming operations include felling trees and cutting them into logs or firewood, but do not include sawing logs into lumber, chipping, or other milling operations. The operations specified in this paragraph (g)(2)(v)(C) will be considered "incidental to farming operations" only if they are of a minor nature in comparison with the total farming operations involved. Therefore, a treefarmer or timbergrower may not claim that a highway motor vehicle used in that trade or business is used directly in agricultural production.

(D) *Use of a highway motor vehicle in connection with the operation, management, conservation, improvement, or maintenance of a farm.* A highway motor vehicle is used directly for agricultural production if it is used in connection with the operation, management, conservation, improvement, or maintenance of a farm and its tools and equipment. Examples of these operations include clearing land, repairing fences and farm buildings, building terraces or irrigation ditches, cleaning tools or farm machinery, painting, and other activities which contribute in any way to the conduct of a farm as such, as distinguished from any other enterprise in which the owner of the highway motor vehicle may be engaged.

(3) *Mileage on farm not counted toward 7,500 mile limit.* For purposes of this section, the number of miles which a highway motor vehicle is driven on a farm and not on the public highways shall not be taken into account when determining whether the vehicle's mileage is in excess of 7,500 miles. Accurate records should be kept by taxpayers of the number of miles that a highway motor vehicle is operated on a farm.

(h) *Owner.* For purposes of this section the term "owner", means, with respect to any highway motor vehicle, the person described in section 4481(b).

Par. 11. New §41.4483-5 and §41.4483-6 are added immediately after newly designated §41.4483-4 to read as set forth below:

§41.4483-5 Termination of exemptions.

The exemptions described in §§41.4483-1 and 41.4483-2 shall not apply on and after October 1, 1988.

§41.4483-6 Reduction in tax for trucks used in logging.

(a) *In general.* The tax imposed by section 4481 shall be reduced by 25 percent in the case of a truck used in logging.

(b) *Truck used in logging.* The term "truck used in logging" means any highway motor vehicle which—

(1) Is used exclusively during the taxable period for the transportation, to and from a point located on a forested site, of products harvested from such forested site, and

(2) Is registered (under the laws of the State or States in which such vehicle is required to be registered) as a highway motor vehicle used exclusively in the transportation of harvested forest products.

Products harvested from the forested site may include timber which has been processed for commercial use by sawing into lumber, chipping or other milling operations if such processing occurs prior to transportation from the forested site. A vehicle will be considered to be registered under the laws of a state as a highway motor vehicle used exclusively in the transportation of harvested forest products if such vehicle is so registered under a state statute or legally valid regulations. In addition, no special tag or license plate identifying a vehicle is being used in the transportation of harvested forest products is required.

Par. 12. Section 41.6001-1 is amended as follows:

(a) Paragraphs (a)(2), (a)(3), (a)(4), (a)(5), (a)(6), and (a)(7) are redesignated as paragraphs (a)(3), (a)(4), (a)(5), (a)(6), (a)(7), and (a)(8) respectively; a new paragraph (a)(2) is

added to read as set forth below; and the paragraph (a) introductory text, paragraph (a)(1), and newly designated paragraphs (a)(6) and (a)(7) are revised to read as set forth below.

(b) Paragraphs (c) and (d) are redesignated as paragraphs (d) and (e) respectively.

(c) A new paragraph (c) is inserted immediately after paragraph (b) to read as set forth below.

(d) Newly designated paragraph (e)(2) is revised to read as set forth below.

§41.6001-1 Records.

(a) *Records to be kept.* Every person in whose name a highway motor vehicle having a taxable gross weight of at least 55,000 pounds is registered or required to be registered at any time during the taxable period shall keep records sufficient to enable the district director to determine whether such person is liable for the tax and, if so, the amount thereof. See §41.4482(b)-1 for the definition of taxable gross weight. Such records shall show with respect to each such vehicle:

(1) A description of the vehicle (including serial number or manufacturer's number) in sufficient detail to permit positive identification of the vehicle.

(2) The weight of the loads carried by the vehicle in such form as is required under the laws of any State in which the vehicle is registered or required to be registered, in order to permit verification of such vehicle's taxable gross weight.

* * * * *

(6) In the case of any such vehicle disposed of otherwise than by sale or other transfer (including disposition by theft or destruction for taxable periods after June 30, 1984), the date and method of disposition of the vehicle.

(7) In the case of a secondhand highway motor vehicle acquired at any time in the taxable period, evidence showing whether there was a prior taxable use in such taxable period of the highway motor vehicle (see paragraph (b) of §41.4481-2) or, for taxable periods after June 30, 1984, whether there was a suspension of tax in effect (see §41.4483-3). For filing requirements of purchaser of second-hand vehicle, see paragraph (b) of §41.6011(a)-1.

* * * * *

(c) *Exemption for vehicles used 5,000 miles or less.* The owner of a highway motor vehicle who reasonably expects the vehicle to be exempt from the tax under section 4481(a) by reason of §41.4483-3(c) for a given taxable period shall keep records which indicate the reason that the use of the vehicle is not expected to exceed 55,000 miles on public highways.

* * * * *

(e) * * *

(2) Records required by paragraph (a) of this section shall be maintained for a period of at least 3 years after the date the tax becomes due or the date the tax is paid, whichever is the later. Records required by paragraphs (b) and (c) of this section shall be maintained for a period of at least 3 years after the end of the taxable period for which such exemption applies. Records required by paragraph (d) of this section (including any record required by paragraphs (a), (b), or (c) of this section which relates to a claim) shall be maintained for a period of at least 3 years after the date the claim is filed.

Par. 13. A new §41.6001-2 is inserted immediately after §41.6001-1 to read as follows:

§41.6001-2 Proof of payment for state registration purposes.

(a) *In general.* This section sets forth the circumstances under which a State must require proof of payment of the tax imposed by section 4481(a), and the required manner in which such proof of payment is to be received by the State as a condition of issuing a registration for a highway motor vehicle. A State must either comply with the provisions of this section or, in the alternative, comply with such other rules regarding the satisfaction of this proof of payment requirement as may be prescribed by the Commissioner (by Revenue Procedure or otherwise), in order to avoid a reduction of Federal-aid highway funds apportioned under 23 U.S.C. 104(b)(5). The rules of this section apply to highway motor vehicles for which applications for registration are received by a State on or after October 1, 1985. For purposes of this section, an application for registration which is mailed will be considered to be received by a State on the date on which it is postmarked.

(b) *Proof of payment required—* (1) *In general.* A State to which an application is made to register a highway motor vehicle must receive from the registrant proof of payment of the tax imposed by section 4481(a) (or proof of suspension of such tax under §41.4483-3) unless otherwise provided in this paragraph (b)(1), or paragraph (b)(2) or (5) of this section. See paragraph (c) of this section for the meaning of "proof of payment". Such proof of payment must be received by the State before the State issues a registration for such vehicle unless the State is using a system of registration provided in paragraph (b)(3) of this section. The term "proof of payment", when used in this section, shall be considered to refer in appropriate cases to proof of suspension of the tax imposed by section 4481(a). Except as provided in paragraph (b)(4) of this section, any proof of payment presented to a State must relate to tax paid (or suspended under §41.4483-3) for the taxable period which includes the date that the State receives the application for registration. A "base state" must be presented proof of payment when issuing an "apportioned plate" under the International Registration Plan (IRP) (or similar agreement) for a highway motor vehicle, but no proof of payment of the tax imposed by section 4481(a) is required to be presented to the other states for which the vehicle is proportionally registered and which are listed on the IRP cab card issued by the base state. Further, a State is not required to receive proof of payment in order to issue special temporary travel permits which allow a vehicle to, (i) operate in a State in which the vehicle is not registered (including proportional or prorate registration), (ii) operate at more than the State's maximum statutory weight limit, or (iii) operate at more than the weight that the vehicle is registered in a State. Further, a State may register a highway motor vehicle without proof of payment if the person registering the vehicle presents the original or a photocopy of sale (or other document evidencing transfer) indicating that the vehicle was purchased by the owner either as a new or used vehicle during the preceding 60 days before the date that

the State receives the application for registration of such vehicle.

(2) *States required to receive proof of payment with respect to vehicles subject to tax*—(i) *Registration in States that register vehicles on the basis of gross weight.* A State that registers vehicles on the basis of gross weight must require proof of payment with respect to any highway motor vehicle that has a declared gross weight in that State of 55,000 pounds or more. If no declaration of a specific gross weight is made with respect to a highway motor vehicles registered on the basis of gross weight, then the State must require proof of payment with respect to such vehicle if the minimum weight of the registered weight category for such vehicle is 55,000 pounds or more. No such proof of payment is required for any vehicle that does not have a declared gross weight in that state of 55,000 pounds or more.

(ii) *Registration in States that register vehicles other than on the basis of gross weight.* A State that registers vehicles other than on the basis of gross weight must require proof of payment in order to register a highway motor vehicle unless the State receives a written statement stating that during the taxable period which includes the date on which the State receives the application for registration, such vehicle had a taxable gross weight of less than 55,000 pounds. The written statement must state the number of vehicles being registered that have a taxable gross weight of less than 55,000 pounds and must be signed by the person registering the vehicles. A State may register a highway motor vehicle without receiving either proof of payment or a written statement as described above if such vehicle has an unladen weight of 8,000 pounds or less. However, the State must require proof of payment when issuing a "base plate" registration for a vehicle if a gross weight declaration of 55,000 pounds or more is made to the State with respect to such vehicle in order to proportionally register the vehicle in another State under the IRP.

(iii) *State may require additional proof.* Nothing contained in this section shall prohibit a State from refusing to register a highway motor vehicle without additional proof that the vehicle is not subject to tax under section 4481(a) even though the person registering the vehicle submits a written statement declaring that the taxable gross weight of such vehicle is less than 55,000 pounds.

(3) *Suspension registration system.* A State may issue a registration with respect to any or all highway motor vehicles subject to tax under section 4481(a) without receiving proof of payment if such vehicles are registered under a "suspension" registration system. Registration of a vehicle subject to tax under a suspension system must be on the condition that, (i) the State receive proof of payment with respect to such vehicle no later than 4 months (or any lesser time to be determined by the State) after the beginning of the vehicle's registration period, and (ii) the State's system provides for the automatic suspension (*e.g.* through the use of computer-generated notices) of such vehicle's registration if no proof of payment is received within the required time. Following such a suspension of registration, the State must not allow the vehicle to be registered until valid proof of payment is received. A State may either register all vehicles subject to tax under section 4481(a) in the manner described in this paragraph (b)(3) or adopt this manner of registration only in situations which the State deems appropriate. A State that registers vehicles other than on the basis of gross weight may also register vehicles not subject to tax under a suspension registration system for purposes of receiving the written statement described in paragraph (b)(2)(ii).

(4) *Registration during certain months.* In the case of a highway motor vehicle subject to tax under section 4481(a) for which a State receives an application for registration during the months of July, August or September, proof of payment for the immediately preceding taxable period may be used to verify payment of the tax imposed by section 4481(a).

(5) *Registration in a State several times during the taxable period.* A State is required to receive proof of payment with respect to a highway motor vehicle subject to tax under section 4481(a) only once during a taxable period. Thus, in the case of a State that allows a highway motor vehicle to be registered on a quarterly basis, rather than annually, proof of payment will be required to be presented to the State only once during the taxable period. The State may designate any one of the four quarterly registration periods as the time for submitting proof of payment.

(6) *Proof of payment records.* See 23 CFR Part 669 for a description of the supporting documentation and records that will be required by the Federal Highway Administration (FHWA) in order to allow the FHWA to verify that the State is in compliance with the rules of this section.

(c) *Proof of payment*—(1) *In general.* (i) The proof of payment required in paragraph (b) of this section shall consist of a receipted Schedule 1 (Form 2290) that is returned by the Internal Revenue Service to a taxpayer who files a return of tax under section 4481(a) and pays the amount of tax (or installment thereof) due with such return. A photocopy of such receipted Schedule 1 shall also serve as proof of payment. Such Schedule 1 shall serve as proof of suspension of such tax under §41.4483-3 for the number of vehicles entered in that part of the Schedule 1 designated for vehicles for which tax has been suspended. Except as provided in paragraph (c)(1)(ii) of this section, the vehicle identification number of the vehicle being registered must appear on the Schedule 1 (or an attached page) in order for the Schedule 1 to be a valid proof of payment for such vehicle.

(ii) If a receipted Schedule 1 is submitted as proof of payment for the registration of one or more highway motor vehicles and—

(A) *(1)* The total of the number of vehicles on such Schedule 1 for which tax has not been suspended under §41.4483-3 exceeds 21, or

(2) The total of the number of vehicles on such Schedule 1 for which tax has been suspended under §41.4483-3 exceeds 9, and

(B) The name of the taxpayer appearing on such Schedule 1 is one of the names in which such vehicles are sought to be registered,

such Schedule 1 shall be accepted as proof of payment in support of the registration of a number of vehicles equal to or less than such total and a list of the vehicles (or their vehicle identifica-

tion numbers) is not required as part of such proof of payment.

(iii) If a Schedule 1 which does not include a list of vehicle identification numbers is submitted as proof of payment for the registration of one or more highway motor vehicles and the name of the taxpayer appearing on such Schedule 1 is not one of the names in which such vehicles are sought to be registered than such Schedule 1 shall be accepted as proof of payment in support of the registration of a number of vehicles equal to or less than the total number of vehicles on such Schedule 1 provided the Schedule 1 is accompanied by a written statement executed by the taxpayer. Such written statement shall contain the vehicle identification numbers of the vehicles sought to be registered and a statement that the tax under section 4481(a) has been paid with respect to such vehicles for the taxable period. The statement must be signed by the taxpayer whose name appears on the Schedule 1.

(2) *Acceptable substitute for receipted Schedule 1.* For purposes of this section, a State shall accept as proof of payment a photocopy of the Form 2290 (with the Schedule 1 attached) which was filed with the Internal Revenue Service for the vehicle being registered with sufficient documentation of payment of tax due at the time the Form 2290 was filed (such as a photocopy of both sides of a cancelled check). This substitute proof of payment may be used to register a vehicle when, for example, the receipted Schedule 1 has been lost, or when at the time required for registration of a vehicle, a receipted Schedule 1 has not been received by a taxpayer who has filed a Form 2290 with respect to such vehicle. The rules of paragraph (c)(1)(ii) of this section regarding the circumstances in which a list of vehicle identification numbers is not required as part of a valid proof of payment, apply to a non-receipted Schedule 1 received by a State with a Form 2290 as a substitute proof of payment under the paragraph (c)(2).

(d) *Examples.* The application of this section may be illustrated by the following examples:

Example (1). A applies to register a 3-axle single unit truck in State R, a member of the International Registration Plan, on November 1, 1985. State R registers vehicles based on unladen weight. At the same time, A applies for a proportional registration under the IRP to use the truck in State S. State S does not register vehicles on the basis of unladen weight. For purposes of the proportional registration in State S, A declares the gross weight of his truck at 50,000 pounds. A does not register the truck in any other states. A's truck has a taxable gross weight, as determined under §41.4482(b)-1(e), of less than 55,000 pounds and therefore is not subject to tax under section 4481(a). A submits a written statement along with his application for registration in State R. The written statement states that A's vehicle has a taxable gross weight of less than 55,000 pounds and is signed by A. State R may register A's truck and issue a proportional registration for A to use his truck in State S without receiving proof of payment.

Example (2). Assume the same facts as an example (1) except that A applies for proportional registration under the IRP in State S and declares the truck to have a gross weight of 60,000 pounds. The taxable gross weight of A's truck, as determined under §41.4482(b)-1(e) is 60,000 pounds. State R may not register A's truck unless it receives proof of payment within the meaning of paragraph (c) of this section.

Example (3). On October 10, 1985, C applies to register 9 vehicles in State U and declares the gross weight of each vehicle to be 70,000 pounds. C has not applied for registration in any other states. At the time of applying for registration, C presents a photocopy of a receipted Schedule 1 (Form 2290) that shows a total of 9 vehicles which are subject to tax under section 4481(a) and for which tax is not suspended under §41.4483-3(a). The vehicle identification numbers of the vehicles that C is seeking to register must be listed on the Schedule 1 in order for State U to register the vehicles.

Example (4). On November 10, 1985, B applies to register 10 vehicles in State T jointly in the names of B and F (a fleet operator) and declares each to have a gross weight of 70,000 pounds. B submits along with the registration application, a photocopy of a receipted Schedule 1 (Form 2290) that shows a total of 100 vehicles which are subject to tax under section 4481(a). F is the taxpayer named on the Schedule 1. No vehicle identification numbers are listed on the Schedule 1 and no list of such numbers is attached. State T may consider the Schedule 1 as proper proof of payment under paragraph (c)(1)(ii) of this section and may register B's vehicles.

Par. 14. The authority citation for Part 48 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 15. Sections 48.6427-1T and 48.6427-2T are removed and new §§48.6427-2 through 48.6427-7 are inserted immediately after §48.6427-1 to read as follows:

§§48.6427-2 through 48.6427-5 [Reserved].

§48.6427-6 Limitation on credit or refund of tax paid on fuel used in intercity, local or school buses after July 31, 1984.

(a) *Limitation on amount of credit or refund*—(1) *In general.* In the case of fuel sold or used after July 31, 1984, on which tax was imposed under section 4041(a), the amount of credit or refund under section 6427(b)(1) shall not exceed 12 cents per gallon except where fuel is used in a bus while such bus is being operated as a "qualified local bus" in which case the credit or refund shall be the full amount of tax paid under section 4041(a) on such fuel.

(2) *Qualified local bus.* A bus is considered to be operated as a "qualified local bus" if such bus—

(i) Is engaged in furnishing (for compensation) intracity passenger land transportation that is available to the general public and is scheduled and along regular routes.

(ii) Has a seating capacity of at least 20 adults (not including the driver), and

(iii) Is under contract with (or is receiving more than a nominal subsidy from) any State or local government (as defined in section 4221(d)(4)) to furnish such transportation.

A company that operates qualified local buses is eligible for a full refund or credit only with respect to fuel used while such buses are operating as qualified local buses. For example, a company that operates its buses along subsidized intracity routes and also on intercity on unsubsidized intracity routes may obtain a full refund or credit only with with respect to fuel used while operating the subsidized intracity routes.

(b) *Meaning of terms*—(1) *Contract with a State or local government.* A bus is under contract with a state or local government only if the contract imposes a bona fide obligation on the operator of the bus to furnish the transportation to which the contract relates.

(2) *More than a nominal subsidy.* A subsidy is more than nominal if the subsidy is reasonably expected to exceed an amount equal to 3 cents multiplied by the number of gallons of fuel used while operating on subsidized routes.

(3) *Intracity passenger land transportation.* The term "intracity passenger and transportation" means the land transportation of passengers to and from points located within the same metropolitan area. The term includes

transportation along routes that cross State, city or county boundaries provided such routes remain within the metropolitan area.

§48.6427-7 Credit or refund of the increased diesel fuel tax to the original purchaser of a diesel-powered automobile or light truck.

(a) *In general.* A credit or refund of the diesel fuel differential amount may be claimed under section 6427(g) for a qualified diesel-powered highway vehicle purchased after January 1, 1985, and before January 1, 1988. A credit or refund of a fraction of the diesel fuel differential amount may be claimed for certain qualified diesel-powered highway vehicles held on January 1, 1985. Any person who is, or is treated as, an original purchaser of a qualified diesel-powered highway vehicle is eligible to claim a credit or refund of the diesel fuel differential amount (or fraction thereof). No interest is payable on the diesel fuel differential amount (or fraction thereof).

(b) *Original purchaser*—(1) *In general.* Generally, an original purchaser is the first person to purchase a new qualified diesel-powered highway vehicle after January 1, 1985 for a use other than resale. In addition, a person holding a qualified diesel-powered highway vehicle for a use other than resale at the end of January 1, 1985, is treated as an original purchaser. For purposes of determining the holder of the vehicle at the end of January 1, 1985, the owner of the vehicle for federal income tax purposes is treated as the holder of the vehicle. However, State or local governments (as defined in section 4221(d)(4)) or nonprofit educational organizations (as defined in section 4221(d)(5)), do not qualify as original purchasers or as holders who are treated as original purchasers.

(2) *Use other than resale*—(i) *Use of a vehicle by a dealer as a demonstrator.* The use of a new vehicle by a dealer as a demonstrator will not be treated as a use other than resale, nor will it cause the vehicle to be treated as other than new when sold by a dealer. Thus, a dealer may not claim a credit or refund under the section for a vehicle used as a demonstrator vehicle; rather, the first person to purchase the demonstrator vehicle for a use other than resale will qualify as the original purchaser of the vehicle.

(ii) *Treatment of leased vehicles.* The lease or rental of a vehicle is treated as a use other than resale both in the case of vehicles purchased after January 1, 1985, and vehicles held at the end of such date. Thus, for example, a person who purchases a qualified diesel-powered highway vehicle on January 15, 1985, and leases the vehicle under the either a long-term or short-term lease under which the leasee is not treated as the owner for Federal income tax purposes, is eligible to claim a credit or refund for the diesel fuel differential amount. In addition, a person who is the owner-lessor of a vehicle leased to a lessee under either a long-term or short-term lease in effect at the end of January 1, 1985, will be treated as the holder over at the end of January 1, 1985 (unless the lease is treated as a sale for Federal income tax purposes).

(3) *Vehicles subject to a lien.* If a person purchases a vehicle subject to a lien and registers the vehicle in the name of the lienholder, the purchaser is eligible to claim the credit or refund even if the lienholder holds nominal title to the vehicle.

(c) *Qualified diesel-powered highway vehicle.* A qualified diesel-powered highway vehicle is any diesel-powered highway vehicle (as defined in §48.4041-7(b)) which—

(1) Has at least 4 wheels,

(2) Has a gross vehicle weight rating (within the meaning of §48.406(a)-1(f)(3)) of 10,000 pounds or less, and

(3) Is registered for highway use in the United States under the laws of any State.

(d) *Diesel fuel differential amount*—(1) *In general.* The diesel fuel differential amount is $102 in the case of a vehicle other than truck or van and $198 in the case of a truck or van. A van for this purpose is a vehicle which has no body sections protruding more than 30 inches ahead of the lead edge of the windshield.

(2) *Amount of credit or refund.* The amount of credit or refund allowable to a person holding a qualified diesel-powered highway vehicle on January 1, 1985, depends upon the model year of the vehicle. The table below sets forth the applicable amounts:

Model year of qualified diesel-powered powered highway vehicle:	Amount: Other than truck or van:	Truck or van:
1984 or 1985	$102	$198
1983	85	165
1982	68	132
1981	51	99
1980	34	66
1979	17	33

No credit or refund is allowed in the case of a 1978 or earlier model year vehicle. The model year designated by the manufacturer for the vehicle is the model year for purposes of the table.

(e) *Reduction in basis.* For purposes of subtitle A of the Internal Revenue Code, the basis of any qualified diesel-powered highway vehicle is reduced (but not below zero) by the diesel fuel differential amount (or fraction thereof) allowable with respect to such vehicle. For example, if a qualified diesel-powered highway vehicle is purchased for business purposes by an original purchaser on January 2, 1985, the basis of such vehicle for purposes of determining depreciation, investment tax credit, and the amount of gain or loss to be recognized upon a disposition of the vehicle is reduced by $102 in the case a vehicle other than a truck or van, and $198 in the case of a truck or van. Such basis reduction shall be considered to occur on the date of purchase or, in the case of a vehicle held on January 1, 1985, on such date.

(f) *Deduction for business purposes.* The availability or claiming of the diesel fuel differential amount (or fraction thereof) as a credit or refund has no effect on the availability to the taxpayer of any otherwise allowable deduction for the cost of diesel fuel purchased by

the taxpayer.

(g) *Claiming the credit or refund*—(1) *One-time claim.* The diesel fuel differential amount (or fraction thereof) may be claimed only once for a qualified diesel-powered highway vehicle. The claim is made by the original purchaser or person treated as the original purchaser, and is claimed as an income tax credit, unless such person is eligible under section 6427(j) to file a claim for refund in lieu of an income tax credit.

(2) *Procedure for claiming the diesel fuel differential amount as an income tax credit.* The amount of credit determined under paragraph (d) of this section is entered on Form 4136 together with any other credits to be entered on such Form. The Form 4136 is then attached to the original purchaser's income tax return.

(3) *Time for claiming credit.* In case of a qualified diesel-powered highway vehicle purchased by an original purchaser after January 1, 1985, and before January 1, 1988, the credit is claimed on the income tax return for the taxable year during which the vehicle was purchased. In the case of a person who is treated as an original purchaser by reason of holding the vehicle at the end of January 1, 1985, the credit is claimed on the income tax return for the taxable year which includes December 31, 1984, *i.e.*, the tax return for 1984 in the case of a calendar year taxpayer.

(4) *Procedure for claiming the diesel fuel differential amount as a refund.* The diesel fuel differential amount may be claimed by the original purchaser or person treated as to the original purchaser or person treated as the original purchaser, as a refund by filing Form 843 (Claim) with the Internal Revenue Service.

Par. 16. The authority citation for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 17. Section 602.101(c) is amended by inserting in the appropriate places in the table:

"§41.4481-1	1545-0143"
"§41.4481-2(b)	1545-0143"
"§41.4483-3	1545-0143"
"§41.6001-1	1545-0143"
"§41.6001-2	1545-0143"
"§48.6427-7	1545-0143"

JAMES I. OWENS,
Acting Commissioner of Internal Revenue.

Approved May 16, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 22, 1985, 8:45 a.m., and published in the issue of the Federal Register for May 23, 1985, 50 F.R. 21243)

Section 4482.—Definitions

26 CFR 41.4482(b)-1: Definition of taxable gross weight.

Imposition of tax on use of heavy vehicles and credits and refunds of tax on sale of diesel fuel. See T.D. 8027, page 263.

Section 4483.—Exemptions

26 CFR 41.4483-3: Exemption for trucks used for 5,000 or fewer miles and agricultural vehicles used for 7,500 or fewer miles on public highways.

Imposition of tax on use of heavy vehicles and credits and refunds of tax on sale of diesel fuel. See T.D. 8027, page 263.

Chapter 42.– Private Foundations; Black Lung Benefit Trusts
Subchapter A.—Private Foundations

Section 4941.—Taxes on Self-Dealing

26 CFR 53.4941(d)-1: Definition of self-dealing.

Private foundations; self-dealing; incidental benefit to disqualified person. A loan program of a private foundation that provides financing to publicly supported organizations for construction projects in disadvantaged areas does not result in acts of self-dealing within the meaning of section 4941 of the Code merely because certain individuals involved in the construction projects have ordinary banking and business relationships with a bank that is a disqualified person.

Rev. Rul. 85-162

ISSUE

The Internal Revenue Service has been asked whether the loan program of a private foundation that provides financing to publicly supported organizations for construction projects in disadvantaged areas results in acts of self-dealing within the meaning of section 4941 of the Internal Revenue Code because some contractors and subcontractors involved in the contruction projects, their suppliers, and employees of those involved may have ordinary banking and business relationships with a bank that is a disqualified person.

FACTS

P is exempt from federal income tax under section 501(c)(3) of the Code, and is a private foundation within the meaning of section 509(a). *B* is a bank that is a disqualified person with respect to *P* within the meaning of section 4946.

In furtherance of its desire to support the revitalization of inner city areas suffering from blight and decay, *P* has entered into a master loan agreement with *C*, an organization that supports community development organization by furnishing assistance to them. *C* is exempt under section 501(c)(3) of the Code and is not a private foundation because it is described in section 170(b)(1)(A)(vi) and 509(a)(1).

Under the master loan agreement, *P* has extended an interest-free line of credit to *C*, which will re-lend the borrowed funds at substantially below-market interest rates to the community development organizations. Loans under this line of credit are program-related investments within the meaning of section 4944(c) of the Code. The master loan agreement requires that each community development organization must be described in section 501(c)(3) or 170(c)(1) of the Code, and must not be a private foundation under section 509.

Each community development organization uses the proceeds of its loan from *C* to purchase a certificate of deposit from a financial institution other than *B* or any disqualified person with respect to *P*. The purchase of the certificate of deposit facilitates acquisition of financing for construction of projects (primarily residential) in economically disadvantaged areas of the United States. The master loan agreement provides that no construction or permanent financing will be provided by a disqualified person with respect to *P*. The master loan agreement also provides that *P* must approve in advance all of *C*'s loans to community development organizations, and must disburse funds to *C* only as *C* disburses funds to

such organizations.

Each community development organization has sole control over the selection of general contractors, subcontractors, and suppliers for its projects. Neither *P* nor any disqualified person with respect to *P* participates in such selection. Furthermore, loan proceeds are not to be set aside for, directed to, or conditioned upon, the use of contractors or suppliers selected by *P* or by any disqualified person with respect to *P*.

Some general contractors, subcontractors, suppliers, or their employees, however, may have ordinary banking or business relationship with *B* or its affiliates. However, no preferential treatment is accorded by reason of these relationships.

LAW AND ANALYSIS

Section 4941 of the Code imposes a tax on each act of self-dealing between a disqualified person and a private foundation. Section 4941(d)(1)(E) provides that the term "self-dealing" includes any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or the assets of a private foundation.

Section 53.4941(d)-2(f)(2) of the Foundation Excise Tax Regulations provides that the fact that a disqualified person receives an incidental or tenuous benefit from the use of a foundation of its income or assets will not, of itself, make such use an act of self-dealing. This is illustrated by *Example* (1) of section 53.4941(d)-2(f)(4), which considers a grant by a private foundation to the governing body of a city for the purpose of alleviating the slum conditions that exist in a particular neighborhood of a city. A corporation that is a substantial contributor to the foundation, and thus a disqualified person with respect to the foundation, is located in the same area in which the grant is to be used. Although the general improvement of the area may constitute an incidental or tenuous benefit to the corporation, such benefit by itself will not constitute an act of self-dealing under section 4941 of the Code.

Rev. Rul. 80-310, 1980-2 C.B. 319, concerns a grant made by a private foundation to an exempt university to establish an educational program providing instruction in manufacturing engineering. A corporation that is a disqualified person with respect to the private foundation intends to hire graduates of the new program and encourage its employees to enroll, but will not receive preferential treatment in recruiting graduates or enrolling its employees. Rev. Rul. 80-310 holds that the grant does not constitute an act of self-dealing within the meaning of section 4941 of the Code because any benefit to the corporation is incidential.

In this case, as in the slum clearance program described in *Example* (1) of section 53.4941(d)-2(f)(4) of the regulations, and as in the grant described in Rev. Rul. 80-310, providing financing for alleviating conditions in disadvantaged areas is a program of broad public interest. The loan agreement prohibits the community development organizations from purchasing certificates of deposit from *B* or any other disqualified person with respect to *P*; prohibits disqualified persons with respect to *P* from providing construction or permanent financing; and provides that *P* and any disqualified person with respect to *P* will neither participate in the selection of contractors, subcontractors, or suppliers, nor influence such selection. Thus, if any benefit to *B* or some other disqualified person with respect to *P* would result from an ordinary banking and business relation with a contractor, subcontractor, supplier, or an employee of those parties in the described construction projects, such benefit would be incidental or tenuous within the contemplation of section 53.4941(d)-2(f)(2).

HOLDING

The loan program of a private foundation that provides financing to publicly supported organizations described in section 170(b)(1)(A)(vi) of the Code for construction projects in disadvantaged areas does not result in acts of self-dealing within the meaning of section 4941 merely because contractors and subcontractors involved have ordinary banking and business relationships with a bank that is a disqualified person with respect to such foundation.

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26 CFR 53.4941(d)-2: Specific acts of self-dealing.

Treatment of loans without interest. See T.D. 8045, page 343.

Section 4945.—Taxes On Taxable Expenditures

26 CFR 53.4945-4: Grants to individuals. (Also Section 501; 1.501(c)(3)-1.)

Private foundations; taxable expenditures; scholarships to relatives of trust's grantor. A private foundation trust that awards scholarships on a preferential basis to family members and relatives of the trust's grantor does not award such scholarships on an objective and nondiscriminatory basis as required by section 4945(g) of the Code.

Rev. Rul. 85-175

ISSUE

Whether scholarship grants awarded under a procedure that gives preference to family members and relatives of the trust's grantor are awarded on an objective and nondiscriminatory basis as required by section 4945(g) of the Internal Revenue Code.

FACTS

A trust described in section 501(c)(3) of the Code and classified as a private foundation under section 509(a) plans, as an insubstantial part of its activities, to create a scholarship program for the benefit of students residing in the United States. The scholarships awarded pursuant to this program will be subject to the provisions of section 117(a) and will be used for study at educational institutions described in section 170(b)(1)(A)(ii). Under this program, scholarships will be awarded on the basis of financial need and academic achievement. The trust's procedures for awarding scholarships provide that in the event the financial need and academic achievement of several scholarship candidates is substantially the same, preference may be given to those candidates who are family members and relatives of the trust's grantor.

LAW

Section 4945 of the Code imposes an excise tax on the taxable expenditures of a private foundation. Under section 4945(d)(3), the term "taxable expenditures" includes any amount paid or incurred by a private foundation as a

grant to an individual for travel, study, or other similar purposes by such individual, unless the grant satisfies the requirements of section 4945(g).

Section 4945(g) of the Code provides that section 4945(d)(3) shall not apply to certain individual grants awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary or his delegate, and if the presence of any one of the three criteria set forth in subsections (1), (2), and (3) is demonstrated to the satisfaction of the Secretary.

Section 53.4945-4(b)(1) of the Foundation and Similar Excise Taxes Regulations provides that grants are not awarded on an objective and nondiscriminatory basis unless the grants are awarded in accordance with a program which, if it were a substantial part of the foundation's activities, would be consistent with the existence of the foundation's exempt status under section 501(c)(3) of the Code.

Section 53.4945-4(b)(2) of the regulations provides, in part, that ordinarily the selection of grantees on an objective and nondiscriminatory basis requires that the group from which the grantees are selected must be sufficiently broad so that the giving of grants to members of that group would be considered to fulfill a purpose described in section 170(c)(2)(B).

Section 53.4945-4(b)(3) of the regulations provides that, in order to be objective and nondiscriminatory within the meaning of section 4945(g), the criteria for selecting grant recipients from the group of potential grantees should be related to the purpose of the grant. Proper criteria might include (but are not limited to) prior academic performance; performance on tests designed to measure ability and aptitude for college work; recommendations from instructors; financial need; and the conclusions which the selection committee might draw from a personal interview as to the individual's motivation, character, ability and potential.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for educational and charitable purposes if no part of the net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

ANALYSIS

An organization's scholarships are not awarded on an objective and nondiscriminatory basis as required by section 4945(g) of the Code unless they are awarded in accordance with a program which, if it were a substantial part of the trust's activities, would be consistent with the trust's exempt status under section 501(c)(3). Likewise, under section 53.4945-4(b)(3) of the regulations, an organization's criteria for selecting grant recipients must be related to the purpose of the grant.

That part of the trust's grant program that gives preference to family members and relatives of the trust's grantor is not consistent with exempt status under section 501(c)(3) of the Code because it serves a private purpose of the grantor rather than a public purpose. If this program were a substantial part of its activities, the trust would not be described in section 501(c)(3). Moreover a preference accorded to family members and relatives is not a criterion, like financial need and academic achievement, that is related to the purpose of an educational grant. Consequently, the trust's grants are not awarded on an objective and nondiscriminatory basis as required by section 53.4945-4(b) of the regulations.

HOLDING

Scholarship grants awarded under a procedure giving preference to family members or relatives of the trust's grantor are not awarded on an objective and nondiscriminatory basis as required by section 4945(g) of the Code.

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26 CFR 53.4945-4: Grants to individuals.

Clarification of Rev. Proc. 76-47, 1976-2 C.B. 670, and Rev. Proc. 80-39, 1980-2 C.B. 772, which respectively provide guidelines to be used in determining whether educational grants made by a private foundation under an employer-related grant program qualify as scholarships or fellowship grants subject to the provisions of section 117 of the Code, and whether educational loans made by a private foundation under an employer-related grant program are taxable expenditures under section 4945. See Rev. Proc. 85-51, page 717.

Section 4947.—Application of Taxes to Certain Nonexempt Trusts

26 CFR 53.4947-1: Application of tax.

Whether an organization, which otherwise qualifies as a private foundation, satisfies the organizational test set forth in section 1.501(c)(3)-1(b)(4) of the regulations by virtue of having satisfied the governing instrument provisions of section 508(e). See Rev. Rul. 85-160, page 162.

Chapter 45.—Windfall Profit Tax on Domestic Crude Oil
Subchapter B.—Categories of Oil

Section 4993.—Incremental Tertiary Oil

26 CFR 150.4993-1: Incremental tertiary oil.

Windfall profit tax; incremental tertiary oil; tertiary recovery method. The injection of a nonhydrocarbon gas (nitrogen) into the gas cap of an oil reservoir is not an approved tertiary enhanced recovery method under section 4993(d)(1)(B) of the Code.

Rev. Rul. 85-141

ISSUE

Whether the injection of a nonhydrocarbon gas into the gas cap of an oil reservoir is an approved tertiary enhanced recovery method under section 4993(d)(1)(B) of the Internal Revenue Code.

FACTS

The taxpayer injected a nonhydrocarbon gas (nitrogen) into the gas cap of an oil reservoir, rather than into the oil zone, to displace oil.

LAW AND ANALYSIS

Section 4993(c)(2)(A) of the Code provides that for a project to qualify as a tertiary recovery project it must involve the application (in accordance with sound engineering principles) of one or more tertiary recovery methods which can reasonably be expected to result in more than an insignificant increase in the amount of crude oil which will ultimately be recovered.

Section 4993(d)(1) of the Code provides that the term "tertiary recovery method" means—

(A) any method which is described in subparagraphs (1) through (9) of section 212.78(c) of the June 1979 energy regulations, or

(B) any other to provide tertiary enhanced recovery which is approved by the Secretary for purposes of the windfall profit tax on domestic crude oil.

In the case of an immiscible nonhydrocarbon gas displacement method, the Secretary will approve under section 4993(d)(1)(B) of the Code as a tertiary enhanced recovery method, only a method that involves the injection of such gas into the oil zone of a reservoir to obtain a chemical or physical reaction (other than mere pressure) between the oil and the injectant.

HOLDING

The injection of a nonhydrocarbon gas into the gas cap of an oil reservoir is not an approved tertiary enhanced recovery method under section 4993(d)(1)(B) of the Code because that method does not utilize a process that acts directly on the oil zone of the reservoir.

Section 4994.—Definitions and Special Rules Relating to Exemptions

26 CFR 51.4994-1: Definitions relating to exemptions.
(Also Sections 4997 6430; 51.4997-2(c), 51.6430-1.)

T.D. 8055

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 51—EXCISE TAX REGULATIONS UNDER THE CRUDE OIL WINDFALL PROFIT TAX ACT OF 1980; SUBCHAPTER H, PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Credit or Refund of Windfall Profit Tax Paid by a Trust

AGENCY: Internal Revenue Service, Treasury

ACTION: Final regulations.

SUMMARY: This document contains final regulations under sections 4994, 4997, and 6430 relating to a credit or refund of windfall profit tax paid by a trust with respect to royalty oil to certain beneficiaries of that trust. Changes to the applicable law were made by the Technical Corrections Act of 1982 [Pub. L. 97-448, 1983-1 C.B. 451]. These final regulations provide the public with guidance needed to comply with the law as amended by that Act.

DATE: These amendments are effective with respect to crude oil removed (or deemed removed) during calendar years beginning after December 31, 1981.

FOR FURTHER INFORMATION CONTACT: John G. Schmalz of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3516, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On November 20, 1984, the FEDERAL REGISTER published proposed regulations under section 6430 relating to a credit or refund of windfall profit tax paid by a trust with respect to royalty oil to certain trust beneficiaries. The amendments were proposed to conform the regulations to section 106(a)(4)(A) of the Technical Corrections Act of 1982 (96 Stat. 2388).

Two written comments on the proposed regulations were received. A public hearing was not requested.

EXPLANATION OF THE PROVISIONS

The final regulations essentially adopt the rules forth in the notice of proposed rulemaking without substantive change.

Under section 6430(a) and the final regulations, any portion of the windfall profit tax paid by a trust which is attributable to a qualified beneficiary is treated as an overpayment of windfall profit tax by such beneficiary. This overpayment is to be credited against any windfall profit tax imposed on the beneficiary or refunded to the beneficiary. An overpayment is attributable to a qualified beneficiary to the extent that windfall profit tax is paid by the trust, with respect to the qualified royalty production of the trust that is allocated, in accordance with rules contained in section 6430 and the final regulations, to such qualified beneficiary.

Under section 6430(b) and the final regulations, the amount under section 6430(a) is limited to an amount attributable to the beneficiary's unused exempt royalty limit for the calendar year. The final regulations also provide rules for allocating the qualified royalty production of the trust between the trust and its income beneficiaries and definitions for the terms "qualified beneficiary," "qualified royalty production" and "producer."

The final regulations provide that a qualified beneficiary shall treat a credit for, or refund of, windfall profit tax determined under section 6430 as an additional distribution to such beneficiary of distributable net income (DNI) of the trust. The beneficiary shall then include this additional distribution of DNI in income. This rule is designed to reflect the fact that taxes generating the overpayment are deductible by the trust against its income tax liability even though such taxes have been refunded to the trust's beneficiaries. If the trust had paid or incurred the net amount of windfall profit tax during the year (*i.e.*, net of the overpayment) and claimed the corresponding deduction for taxes, the trust would have had additional DNI to distribute to its beneficiaries. This additional DNI to the trust would then generate an additional deduction to the trust when distributed to the beneficiaries, and the beneficiaries would have included such distribution in gross income. Absent the rule described in this paragraph, the beneficiary would, in effect, be getting a distribution of DNI from the trust tax-free.

The final regulations also clarify that section 6430 is not available to the extent that the trust is a grantor trust (*i.e.*, a trust the income of which is taxed to a grantor, or other person, under subchapter J of the Code) since a grantor trust does not have adjusted distributable net income and since the grantor, rather than the trust, is generally the producer in the case of a grantor trust.

Under section 4994(f)(2)(C) and the final regulations, a qualified beneficiary may elect to increase the credit under section 6430 by reducing the royalty owner's exemption under section 4994(f).

The final regulations also contain an amendment to the regulations under section 4997 which would impose on a trust the requirement to furnish to each

qualified beneficiary a Form 6248.

PUBLIC COMMENTS

Two public comments were received. The first comment related to a requirement of Texas law that a trustee charge the income account for all windfall profit tax while reserving 27 ½ percent of the gross mineral proceeds for addition to principal. The commentator asked that the regulations be changed to provide that windfall profit tax paid by a trust with respect to the trust's share of production be treated as an overpayment of windfall profit tax under section 6430 if the tax is charged against the income beneficiaries' accounts even though the tax is not paid with respect to the beneficiaries' allocable trust production. However, section 6430 authorizes the treatment of windfall profit tax paid by a trust as an overpayment of tax by a trust beneficiary only if that tax is paid by the trust with respect to that beneficiary's allocable trust production. Therefore, this change was not made.

The second comment concerned the requirement in section 6430(c)(2)(A)(ii) and §51.6430-1(c)(2) that production be allocated between the trust and the income beneficiaries in accordance with their respective shares of the adjusted distributable net income for the calendar year. One commentator stated that it would be overly burdensome to require a fiscal year trust to compute adjusted distributable net income on a calendar year basis. Section 6430(c)(2)(A)(ii), however, speaks in terms of a calendar year calculation. As a result, no change was made.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this final rule is not subject to review under Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required. The Internal Revenue Service has concluded that the final regulations contained herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U:S.C. chapter 6).

PAPERWORK REDUCTION ACT

The collection of information requirements contained in this regulation have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these final regulations is John G. Schmalz of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 51 and 602 are amended * * * [as follows]:

Paragraph 1. The authority for Part 51 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * Section 51.6430-1 also issued under 26 U.S.C. 6430(e).

Par. 2. Section 51.4994-1 is amended by revising paragraph (f)(4) as follows:

§51.4994-1 Definitions relating to exemptions.

* * * * *

(f) Exempt royalty oil. * * *

(4) *Royalty limit*—(i) *In general.* Except as provided in paragraph (f)(4)(iv) of this section, a qualified royalty owner's qualified royalty production is determined by applying section 4994(f)(2)(A).

(ii) *Production exceeds limitation* If a qualified royalty owner's qualified royalty production for any quarter exceeds the royalty limit in section 4994(f)(2)(A) for such quarter, the royalty owner may allocate the royalty limit for such quarter to any qualified royalty production that the royalty owner selects.

(iii) *Allocation of royalty limit among taxpayers.* For the purpose of allocating the royalty limit in section 4994(f)(2)(A) among taxpayers, section 6429(c)(2) through (4) will be applied except that the royalty limit determined under section 4994(f)(2)(A) is substituted in place of $2,500 each time it appears in section 6429(c)(2) thru (4).

(iv) *Election to increase section 6430 royalty credit by reducing the royalty owner's exemption.* Any qualified royalty owner who is a qualified beneficiary (within the meaning of section 6430 and §51.6430-1(d)(1)) for any quarter may elect, by way of a marginal notation on Form 6249, to reduce by any amount the qualified royalty owner's royalty limit determined under section 4994(f)(2)(A) for such quarter after applying paragraph (f)(4)(iii) of this section.

* * * * *

Par. 3. Paragraph (c) of §51.4997-2 is amended by adding at the end thereof a new paragraph (c)(7) to read as follows:

§51.4997-2 Certain information to be furnished by producers and others.

* * * * *

(c) *Yearly statement of windfall profit tax liability* * * *

* * * * *

(7) *Trusts with qualified royalty production.* In the case of any trust that is a producer (within the meaning of paragraph (b) of §51.4996-1), that has qualified royalty production for the calendar year (within the meaning of §51.6430-1(d)(2)) and that has beneficiaries who are qualified beneficiaries (within the meaning of §51.6430-1(d)(1)), such trust shall furnish to each qualified beneficiary, and file with the Internal Revenue Service, a Form 6248 in accordance with that form's instructions and the rules of this paragraph. A separate statement shall be furnished to, and a separate information return shall be filed for, each qualified beneficiary.

* * * * *

Par. 4. There is added immediately after §51.6402-1 the following new section:

§51.6430-1 Credit or refund of windfall profit tax to certain trust beneficiaries.

(a) *General rule.* Except as otherwise provided in paragraph (b) of this

section, that portion of the crude oil windfall profit tax imposed by section 4986 which is paid by any trust with respect to any qualified beneficiary's allocable trust production (within the meaning of paragraph (c) of this section) shall be treated as an overpayment of such tax by such qualified beneficiary. The overpayment described in this paragraph (a) is deemed to be made on the day that an overpayment by the trust would be deemed to be made if the trust's payment of such tax with respect to the same crude oil were an overpayment. Any such overpayment shall be credited against the crude oil windfall profit tax liability of such qualified beneficiary or shall be refunded to such qualified beneficiary. See paragraph (b) of this section for a rule that coordinates this credit or refund with the exemption for exempt royalty oil provided in section 4994(f) and which may require a reduction of the amount determined under this paragraph. See paragraph (d) of this section for definitions of the terms "qualified beneficiary", "qualified royalty production", and "producer".

(b) *Coordination with royalty exemption*—(1) *In general.* If the aggregate amount of the allocable trust production (as defined in paragraph (c) of this section) attributable to any qualified beneficiary exceeds such beneficiary's unused exempt royalty limit for such calendar year, then the amount treated as an overpayment under paragraph (a) of this section with respect to such qualified beneficiary shall be reduced by the amount of the overpayment attributable to such excess. The amount of this reduction is equal to the amount of the overpayment determined under paragraph (a) multiplied by a fraction the numerator of which is the amount of such excess and the denominator of which is the aggregate amount of the beneficiary's allocable trust production, and can be expressed by the following formula:

$$R = O \times \frac{E}{P}$$

Where:

R = The amount of the reduction;

O = the amount of the overpayment determined under paragraph (a) of this section;

E = the amount of the excess; and

P = the aggregate amount of the beneficiary's allocable trust production.

(2) *Unused exempt royalty limit.* The unused exempt royalty limit of any qualified beneficiary for any calendar year is the amount described in section 6430(b)(2) which can be expressed in terms of the following formula:

$$U = (D \times L) - Y$$

Where:

U = the unused exempt royalty limit;

D = the number of the days in such calendar year;

L = the limitation in barrels determined from the table contained in section 4994(f)(2)(A)(ii); and

Y = the amount of exempt royalty oil (within the meaning of section 4994(f)) with respect to which such qualified beneficiary is the producer, and which is removed from the premises during such calendar year.

(c) *Allocable trust production*—(1) *In general.* For purposes of this section, the term "allocable trust production" means, with respect to any qualified beneficiary, the qualified royalty production of any trust (as defined in paragraph (d)(2) of this section) which is removed (or deemed removed) from the premises during the calendar year, and is allocated to such qualified beneficiary under paragraph (c)(2) of this section.

(2) *Allocation of production*—(i) *In general.* The qualified royalty production of a trust for any calendar year shall be allocated between the trust and its income beneficiaries by first allocating to the trust an amount of production based on that portion of the trust income attributable to the qualified royalty production that is set aside under state law in any reserve for depletion for the calendar year, and by then allocating the remaining qualified royalty production between the trust and the income beneficiaries in accordance with their respective shares of the adjusted distributable net income for the calendar year attributable to the qualified royalty production. Adjusted distributable net income not attributable to qualified royalty production and income set aside in a depletion reserve not attributable to qualified royalty production shall not be considered for purposes of this calculation. Furthermore, the calculation must be done on the basis of a calendar year even though the trust's taxable year may be other than a calendar year. Thus, for purposes of this paragraph (c)(2), a fiscal year trust must compute its adjusted distributable net income for the calendar year and its reserve for depletion for the calendar year.

(ii) *Adjusted distributable net income.* The term "adjusted distributable net income" means the distributable net income (as defined in section 643) of the trust for the calendar year reduced by any excess in the amount of income added to any depletion reserve maintained by the trust for the calendar year (regardless of the trust's taxable year) over the depletion deduction allowable to the trust under section 611 with respect to the qualified royalty production of the trust for the calendar year.

(iii) *Allocation pro rata from each unit of production.* Each person's allocable share of the qualified royalty production of the trust is deemed to be a pro rata share of each unit (i.e., type and category, including each base price and removal price category) of oil in such qualified royalty production.

(iv) *Grantor trusts.* To the extent that a trust is a grantor trust (i.e., a trust the income of which is taxed to a grantor, or other person, under subchapter J of the Code), qualified royalty production shall not be allocated to a qualified beneficiary of the trust under this section because, to the extent that a trust is a grantor trust, the trust does not have adjusted distributable net income and the grantor rather than the trust is the producer of the crude oil. (See §51.4996-1(b)(2).)

(3) *Production from transferred Property*—(i) *In general.* The allocable trust production of any qualified beneficiary shall not include any production attributable to an interest in property which has been transferred after June 9, 1981, in a transfer (including changes in beneficiaries of the trust) which is described in section 613A(c)(9)(A), and is not described in section

613A(c)(9)(B).

(ii) *Exception.* Paragraph (c)(3)(i) of this section shall not apply in the case of any transfer so long as the transferor and the qualified beneficiary are required by section 6340(b)(3) to share the amount determined under section 6430(b)(2)(A). The preceding sentence shall apply to the transfer of any property only if the production attributable to the property was allocable trust production of the transferor.

(d) *Definition*—(1) *Qualified beneficiary.* The term "qualified beneficiary" means any individual or estate which is a beneficiary of any trust which is a producer.

(2) *Qualified royalty production of a trust.* The term "qualified royalty production of a trust" generally means, with respect to any trust, taxable crude oil (within the meaning of section 4991(a)) which is attributable to an economic interest of such trust other than an operating mineral interest (within the meaning of section 614(d)). However, such term does not include taxable crude oil attributable to any overriding royalty interest, production payment, net profits interest, or similar interest of the person which—

(A) Is created after June 9, 1981, out of an operating mineral interest in property which is proven oil or gas property (within the meaning of section 613A(c)(9)(A)) on the date such interest is created, and

(B) Is not created pursuant to a binding contract entered into before June 10, 1981.

(3) *Producer.* The term "producer" has the meaning given to such term by paragraph (b) of §51.4996-1.

(e) *Overpayment treated as additional distribution.* Any qualified beneficiary who claims a credit or refund as a result of an overpayment generated under section 6430 must treat the amount of such credit or refund as an additional distribution of distributable net income of the trust. Such distribution shall be in addition to any other amount of distributable net income distributed to such beneficiary, and shall be deemed to be paid or accrued on the date that the credit or refund under this section is paid or accrued.

(f) *Example.* The following examples illustrate the application of the rules of this paragraph:

Example (1). Assume that for the calendar year 1983, Trust A has 2,000 barrels of qualified royalty production, royalty income of $60,000, $10,000 of cash-expenses, and claims a percentage depletion deduction of $9,600 while setting aside $18,000 (2,000 barrels × 30 percent × $30/barrels) of royalty income in a reserve for depletion recognized under state law. Thus, the excess of the reserve for depletion for the year over the amount allowable as a deduction for depletion to the trust for the year is $8,400 ($18,000–$9,600). Assume further that A paid windfall profit tax on the royalty oil removed during the calendar year in the amount of $4,000 ($2 per barrel). Under these facts, the first 600 barrels (2,000 barrels × $18,000/$60,000) of A's qualified royalty production is allocated to A. In addition, A has distributable net income in the amount of $40,400 ($60,000–$10,000–$9,600) and adjusted distributable net income of $32,000 ($40,400–$8,400). If under the provisions of the trust document A distributes the $32,000 of income to the two beneficiaries, B and C, in the amounts of $22,857 and $9,143, respectively, the remaining 1,400 barrels of qualified royalty production (2,000 barrels–600 barrels allocated to the trust) must be allocated between B and C as follows:

1,000 barrels to B (1,400 × (22,857/32,000)) and 400 barrels to C (1,400 × (9,143/32,000)). Assume all of the qualified royalty production is removed from the same property. Under section 6430(a) and paragraph (a) of this section and before the application of section 6430(b) and paragraph (b) of this section, B would be treated as having made an overpayment of windfall profit tax during the calendar year in the amount of $2,000 ($2 × 1,000 barrels) and C would be treated as having made an overpayment in the amount of $800 ($2 × 400 barrels).

Example (2). Assume the same facts as in example (1), and assume that C claimed a royalty owner's exemption under section 4994(f) for the calendar year with respect to 500 barrels of oil held outside the trust. Under these facts, both B and C must reduce the overpayment determined under paragraph (a) of this section. B's unused royalty limit is 730 barrels (365 days × 2 barrels) and the excess of the number of barrels allocated to B in example (1) over the unused royalty limit is 270 barrels (1,000 barrels–730 barrels). C's unused royalty limit is 230 barrels (730 barrels–500 barrels) and the excess of the number of barrels allocable to C in example (1) over the unused royalty limit is 170 barrels (400 barrels–230 barrels). As a result, B must reduce the amount of the overpayment by $540 ($2,000 × (270 barrels/1,000 barrels)) and C must reduce the amount of the overpayment by $340 ($800 × (170 barrels/400 barrels)). Thus, B may claim a credit or refund in the amount of $1,460 ($2,000–$540) and must, if such credit or refund is claimed, treat the $1,460 as an additional distribution of distributable net income. C may claim a credit or refund in the amount of $480 ($800–$340) and must, if such credit or refund is claimed, treat the $480 as an additional distribution of distributable net income.

(g) *Overpayment credited against estimated tax liability.* See section 6654g(3)(B) for a rule that allows a taxpayer to offset the overpayment determined under this section against the taxpayer's liability to make estimated tax payments.

Par. 5. the authority for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 6. Section 602.101(c) is amended by adding in the appropriate places in the table "§51.4994-1(f)(4)(iv) . . . 1545-0224" and "§51.4997-2(c)(7) . . . 1545-0224".

JAMES I. OWENS,
Acting Commissioner of Internal Revenue.

Approved August 30, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on October 7, 1985, 8:45 a.m., and published in the issue of the Federal Register for October 8, 1985, 50 F.R. 40971)

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26 CFR 51.4994-1: Definitions relating to exemptions.
(Also Sections 4995, 4996; 51.4995-2, 51.4996-1.)

T.D. 8056

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 51—EXCISE TAX REGULATIONS UNDER THE CRUDE OIL WINDFALL PROFIT TAX ACT OF 1980; SUBCHAPTER H, PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Definitions Relating to Exemptions From the Windfall Profit Tax

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final Regulations.

SUMMARY: This document contains final Excise Tax Regulations under sections 4994, 4995, and 4996 relating to definitions of exempt oil for purposes of the windfall profit tax. Changes to the applicable law were made by the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 1], the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256], and the Technical Corrections Act of 1982 [Pub. L. 97-448, 1983-1 C.B. 451]. The regulations would provide guidance concerning the requirements for qualifying for these exemp-

tion from the windfall profit tax.

DATE: These regulations are effective generally after February 29, 1980. However, the exemption under §51.4994-1(c)(1)(ii)(D) for economic interests held by qualified residential child care agencies is effective for taxable periods beginning after December 31, 1980, and the provisions under §51.4994-1(f) relating to exempt royalty oil are effective only for oil removed after December 31, 1981.

FOR FURTHER INFORMATION CONTACT: John G. Schmalz of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224, ATTN: CC:LR:T (202-566-3516, not a toll-free call).

SUPPLEMENTARY INFORMATION

BACKGROUND

On February 12, 1985, the FEDERAL REGISTER published proposed amendments to the Excise Tax Regulations (26 CFR part 51) under section 4994, 4995, and 4996 of the Internal Revenue Code of 1954 [LR-69-80, 1985-1 C.B. 629]. The amendments were proposed to conform the regulations to section 101(a)(1) of the Crude Oil Windfall Profit Tax Act of 1980 (94 Stat. 230) [Pub. L. 96-223, 1980-3 C.B. 1, 2], (which added section 4994 to the Internal Revenue Code) as amended by sections 601 and 604 of the Economic Recovery Tax Act of 1981 (95 Stat. 335, 338) [Pub. L. 97-34, 1981-2 C.B. 256, 341, 343] and section 201(f) of the Technical Corrections Act of 1982 (96 Stat. 2393) [Pub. L. 97-448, 1983-1 C.B. 451, 465]. They did not, however, reflect section 106 of the Technical Corrections Act of 1982 because regulations reflecting that section are to be published as part of another regulation project.

No public comments were received, and no public hearing was requested. The final regulations adopt the proposed rules without substantive change.

Evaluation of the effectiveness of the regulations after issuance will be based on comments received from offices within the Internal Revenue Service, the Treasury Department, other governmental agencies, State and local governments, and the public.

EXPLANATION OF THE PROVISIONS

DEFINITIONS RELATING TO EXEMPTIONS

Section 4991(b) provides that the term "exempt oil" (oil not subject to the windfall profit tax) means (1) crude oil from a qualified governmental interest; (2) crude oil from a qualified charitable interest; (3) exempt Indian oil; (4) exempt Alaskan oil; (5) exempt royalty oil; (6) exempt stripper well oil; and (7) exempt front-end oil. Section 4994 and the final regulations provide definitions of these categories of exempt oil, except that the definitions of front-end oil in section 4994(c) and exempt stripper well oil in section 4994(g) are not included as part of these final regulations because they are the subject of other regulation projects.

Section 4994(a) and the final regulations define the term "qualified governmental interest." The interest must be held by a governmental body or its agency or instrumentality and the net income from the interest in crude oil is required to be dedicated to a public purpose. The term "public purpose" is defined by reference to section 170(c)(1) (relating to a charitable contribution made exclusively for public purposes). The term "net income" is also defined.

Section 4994(b) and the final regulations define the term "qualified charitable interest." The interest must be held by an educational organization, an organization that provides medical care, education or research, or an organization operated for the benefit of a state university. The interest must have been held by the organization on January 21, 1980. Special rules are provided for churches and private foundations. In addition, the final regulations clarify the holding requirement.

Under the final regulations, trusts and estates with governmental or charitable beneficiaries may be entitled to exemption from tax liability and withholding.

Section 4994(d) and final regulations define the term "exempt Indian oil." The interest in crude oil must be held by a member of an Indian tribe, an Indian tribe, or an Indian tribal organization. The interest must have been held on January 21, 1980, and must be subject to a restriction on alienation. The final regulations define the term "Indian tribe" and provide special rules relating to native corporations organized under the Alaskan Native Claims Settlement Act.

Section 4994(e) and the final regulations define the term "exempt Alaskan oil." In connection with this definition, the proposed regulations define the term "divides of the Alaskan and Aleutian ranges," and give the longitude and latitude of peaks and elevations for defining the divide for purposes of the Aleutian Islands.

Section 4994(f) and the final regulations provide rules relating to "exempt royalty oil". This exemption is available only to qualifying individuals, estates, and family farm corporations that are producers of crude oil within the meaning of section 4996(a)(1). The exemption is not available to other corporations or to trusts. However, the final regulations contain a clarifying amendment to the regulations under section 4996(a)(1) defining the term "producer". In general, this rule makes it clear that in the case of grantor trusts the grantor, rather than the trust entity, is the producer. As a result, if the grantor is an individual, for example, such grantor may be entitled to claim the exemption under section 4994(f).

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this final rule is not subject to review under Executive Order 12291. The Internal Revenue Service has concluded that the final regulations contained herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

PAPERWORK REDUCTION ACT

The collection of information requirements contained in these regulations have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these final regulations is John G. Schmalz of the

Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 51 and Part 602 are amended * * * [as follows]:

PART 51—[AMENDED]

Paragraph 1. The authority for Part 51 continues to read in part:

Authority: 26 U.S.C. 7805. * * *

Par. 2. Section 51.4994-1 is amended by revising the section heading and adding text to the section to read as follows:

§51.4994-1 Definitions relating to exemptions.

(a) *In general.* Section 4991(b) provides that the term "exempt oil" (oil not subject to the windfall profit tax) means—

(1) Any crude oil from a qualified governmental interest.

(2) Any crude oil from a qualified charitable interest,

(3) Any exempt Indian oil,

(4) Any exempt Alaskan oil,

(5) Any exempt front-end oil,

(6) Any exempt royalty oil, and

(7) Any exempt stripper well oil.

(b) *Qualified governmental interest*—(1) *In general.* Under section 4994(a)(1), a "qualified governmental interest" means an economic interest in crude oil if—

(i) Such interest is held by a State or political subdivision thereof or by an agency or instrumentality of a State or political subdivision thereof, and

(ii) Under the applicable State or local law, all of the net income received pursuant to such interest is dedicated to a public purpose.

(2) *Net income*—(i) *In general.* For purposes of this paragraph, the term "net income" means gross income reduced by production costs, and severance taxes of general application, allocable to the economic interest.

(ii) *Production costs.* For the purposes of paragraph (b)(2)(i) of this section, production costs means all current costs borne by the governmental interest attributable to the production of crude oil. It includes operating expenses, selling expenses, financial and administrative overhead, depreciation, cost depletion (determined on the basis that all intangible drilling costs are capitalized), taxes on the producing property, and interest on debt incurred to finance production. It does not, however, include intangible drilling and development costs (except as provided in the preceding sentence) or interest on any debt incurred to acquire the economic interest.

(3) *Public purposes requirement.* For purposes of this paragraph, the term "public purpose" has the same meaning as in section 170(c)(1). The requirement in paragraph (b)(1)(ii) of this section that all of the net income received be dedicated to a public purpose shall be treated as met if all such net income is either used for a public purpose or placed in a permanent fund 100 percent of the earnings of which are dedicated to a public purpose. Net income used to pay interest on or retire debt incurred to acquire the economic interest will not be considered to be dedicated to a public purpose. The extent to which a debt is incurred to acquire the economic interest shall be determined on the basis of the principles set forth in section 514(c).

(4) *Trusts and estates.* If legal title to an interest in crude oil is held in trust or by an estate, the character of the persons entitled to the income of the trust or the estate shall be imputed to the producer (the estate, the trust, or, in the case of a grantor trust, the grantor of the trust) to determine what portion, if any, of the interest is a qualified governmental interest. Also, for the purpose of this subparagraph, if the fiduciary maintains a reserve for depletion, or accumulates current income, the income set aside in such depletion reserve, or accumulated for future distribution, will be considered to be income of the fiduciary or of a beneficiary other than a qualifying governmental unit to the extent that such income can under any circumstances be distributed at some future time to a beneficiary that does not meet the requirements of section 4994(a). Accordingly, the share of the production of the trust or estate that is exempt under section 4994(a) is determined by dividing the sum of (i) the amount of income of the trust or estate attributable to crude oil for the year that is distributed to a qualified governmental unit, plus (ii) the amount of income from the crude oil production that is set aside that year in a reserve for depletion for the exclusive benefit of a qualified governmental unit, plus(iii) the amount of undistributed income for the year that is accumulated for the exclusive benefit of a qualified governmental unit by (iv) the total income for the year (whether distributed or not) attributable to crude oil.

(c) *Qualified charitable interest*—(1) *In general.* The term "qualified charitable interest" means an economic interest in crude oil if all of the following three requirements are met:

(i) The interest is held by an organization that is described in section 170(c)(2) relating to a corporation, etc., organized and operated exclusively for religious, charitable, etc., purposes).

(ii) The organization holding the interest is also described in one of the following sections:

(A) Section 170(b)(1)(A)(ii) (relating to an educational organization).

(B) Section 170(b)(1)(A)(iii) (relating to an organization that provides medical care, education, or research).

(C) Section 170(b)(1)(A)(iv) (relating to an organization operated for the benefit of a State college or university, or

(D) With respect to taxable periods beginning after December 31, 1980, section 4994(b)(1)(A)(ii) (reflecting to an organization organized and operated primarily for the residential placement, care, or treatment of delinquent, dependent, orphaned, neglected, or handicapped children).

(iii) The interest was held by the organization on January 21, 1980, and at all times thereafter before the last day of the taxable period.

(2) *Churches.* An economic interest is also a "qualified charitable interest" if all of the following four requirements are met:

(i) The interest is held by an organization described in section 170(b)(1)(A)(i) (relating to a church, convention or association of churches),

(ii) The organization holding the interest is also described in section 170(c)(2).

(iii) The interest is held for the benefit of one or more of the organizations described in paragraph (c)(1)(ii) of this section and in section 170(c)(2), and

(iv) The interest was held by the section 170(b)(1)(A)(i) organization on January 21, 1980, and at all times thereafter before the last day of the taxable period.

(3) *Trusts and estates.* (i) If legal title to an interest in crude oil is held in trust or by an estate, the character of the persons entitled to the income of the trust or estate attributable to the crude oil shall be imputed to the producer (the estate, the trust, or, in the case of a grantor trust, the grantor of the trust) to determine what portion, if any, of the interest is a qualified charitable interest. Also, for the purpose of this subparagraph, if the fiduciary maintains a reserve for depletion, or accumulates current income, the income set aside for such depletion reserve, or accumulated for future distribution, will be considered to be income of the fiduciary or of a beneficiary other than a qualifying charity to the extent that such income can under any circumstances be distributed at some future time to a beneficiary that does not meet the requirements of section 4994(b). Accordingly, the share of the production of the trust or estate that is exempt under section 4994(b) is determined by dividing the sum of (A) the amount of income of the trust or estate attributable to crude oil for the year that is distributed to a qualified beneficiary, plus (B) the amount of income from the crude oil production that is set aside that year in a reserve for depletion for the exclusive benefit of a qualified charity, plus (C) the amount of undistributed income for the year that is accumulated for the exclusive benefit of a qualified charity, by (D) the total income for the year (whether distributed or not) attributable to crude oil.

(ii) In applying paragraph (c)(3)(i) of this section, paragraph (c)(1)(iii) of this section will be applied both to the trust or the estate and to its beneficiaries. Accordingly, the trust or the estate must have held the interest for the benefit of a qualifying charity on January 21, 1980, and at all times thereafter before the last day of the taxable period. (See paragraph (c)(4) of this section for special rules relating to the holding requirement.) Furthermore, for the exemption to apply a charitable beneficiary must have had on January 21, 1980, and at all times thereafter before the last day of the taxable period, an unconditional right to receive, either presently or in the future, a fixed amount of the net income from the interest (*e.g.*, a specified dollar amount or an amount determined by a formula).

(4) *Section 509(a)(3) organizations.* An economic interest is also a "qualified charitable interest" if all of the following requirements are met:

(i) The interest is held by an organization described in section 509(a)(3),

(ii) The organization holding the interest is operated exclusively for the benefit of an organization described in—

(A) Section 4994(b)(1)(A)(ii) (relating to organizations organized and operated primarily for the residential placement, care, or treatment of delinquent, dependent, orphaned, neglected, or handicapped children).

(B) Section 170(b)(1)(A)(ii) (relating to educational organizations) which is also described in section 170(c)(2), and

(iii) The interest was held by the section 509(a)(3) organization on January 21, 1980, and at all times thereafter before the last day of the taxable period.

(5) *Holding requirement.* An interest in crude oil is considered "held for the benefit of" one of the organizations described in paragraph (c)(1)(ii) of this section only if all the net income from such interest (as defined in paragraph (b)(2) of this section) was dedicated to the organization on January 21, 1980, and at all times thereafter before the last day of the taxable period. The dedication need not be a formal or written dedication. However, no dedication will be recognized if any of the net income from the interest was in fact used for a purpose other than to benefit the organization or organizations to which it was purportedly dedicated. The requirement of paragraph (c)(1)(iii) and (2)(iii) and (iv) of this section that the interest in crude oil be held by certain organizations on January 21, 1980, or be held on January 21, 1980, "for the benefit of" certain organizations, and at all times thereafter (before the last day of the taxable period) may be satisfied although the identical organization does not hold the interest, or the interest is not held for the benefit of the identical organization, on January 21, 1980, and thereafter. For example, the holding requirements are satisfied if, on January 21, 1980, a church or trust held the interest for the benefit of an educational organization, and later the church or trust transferred the interest to an organization providing medical care, provided that both organizations otherwise meet the requirements of paragraph (c)(1) or (2).

(6) *Relationship to section 501(c)(3).* It is not necessary under this paragraph that the organization holding the interest in crude oil be recognized as exempt under section 501(c)(3).

(d) *Exempt Indian oil.* The term "exempt Indian oil" means any domestic crude oil which meets one or more of the following three requirements:

(1) The producer of the oil is an Indian tribe, an individual member of an Indian tribe, or an Indian tribal organization, under an economic interest held by such a tribe, member, or organization on January 21, 1980, and the oil is produced from mineral interests which are—

(i) Held in trust by the United States for the tribe, member, or organization, or

(ii) Held by the tribe, member, or organization subject to a restriction on alienation imposed by the United States because it is held by an Indian tribe, a member of an Indian tribe, or an Indian tribal organization; or

(2) The producer of the oil is a native corporation organized under the Alaska Native Claims Settlement Act (as in effect on January 21, 1980), and the oil—

(i) Is produced from mineral interests held by the corporations which were received under that Act, and

(ii) Is removed from the premises before 1992; or

(3) The proceeds from the sale of the oil are deposited in the Treasury of the United States to the credit of tribal or native trust funds pursuant to a provision of law in effect on January 21, 1980. The term "Indian tribe" means any group of individuals recognized as an Indian tribe eligible for services pro-

vided to Indians by the Secretary of Interior by his or her delegate. The term "native corporation organized under the Alaska Native Claims Settlement Act" includes a corporation that is a 100 percent-owned subsidiary of such a native corporation.

(e) *Exempt Alaskan Oil*—(1) *In general*. The term "exempt Alaskan oil" means any crude oil (other than Sadlerochit oil) which is produced—

(i) From a reservoir from which oil has been produced in commercial quantities (within the meaning of paragraph (e)(2) of this section) through a well located north of the Arctic Circle,

(ii) From a well located north of the Arctic Circle, or

(iii) From a well located south of the Arctic Circle but on the northerly side of the divides of the Alaskan and Aleutian ranges and at least 75 miles from the nearest point on the Trans-Alaska Pipeline System.

(2) *Commercial quantities*. For a definition of commercial quantities, see paragraph (n) of §51.4996-1. However, for purposes of this section, an unprofitable well located north of the Arctic Circle will not be considered to produce oil in commercial quantities if the only purpose for producing oil from that well is to exempt a reservoir from the windfall profit tax under section 4994(e)(1) and paragraph (e)(1)(i) of this section. For the purpose of the preceding sentence, for a taxable period a well will be considered to be unprofitable if the total current costs of producing the crude oil incurred during the taxable period exceeds the market value of the oil produced from that well during such period.

(3) *Definition of divides of Alaskan and Aleutian Ranges*. The term "divides of the Alaskan and Aleutian ranges" means the ridge or crest of land (with respect to those ranges) that marks the boundary between adjacent drainage basins, on either side of which the heads of steams flow in opposite directions. However, for purposes of the Aleutian Islands only, the divide is deemed to be a line constructed by connecting the main peaks or elevations in the island chain. The location of these peaks are listed in paragraph (e)(4).

(4) *Listing of peaks or elevations for purposes of line through Aleutian Islands*. The peaks or elevations used to construct a dividing line through the Aleutian Islands are as follows (within 2,000 feet accuracy):

LATITUDE	*LONGITUDE*
61 942N	1521950W
605917N	1524742W
605337N	1525442W
604357N	1523438W
603918N	15250 7W
603716N	153 4 6W
603140N	153 850W
602612N	1531657W
60 449N	1532735W
595824N	1532831W
595414N	1532340W
594631N	15336 9W
594016N	15347 5W
592547N	154 357W
591434N	1543843W
59 653N	1544329W
59 041N	1544051W
585459N	15438 7W
5852 7N	1543238W
584743N	1543516W
5843 8N	1543614W
5841 0N	1543131W
583837N	15428 7W
583318N	1542030W
582555N	1542314W
5820 6N	15441 0W
581650N	1545654W
581513N	155 112W
5814 6N	155 6 4W
581143N	1551454W
5810 9N	1552115W
58 5 3N	1551830W
575742N	1551846W
5751 9N	1552628W
574512N	1554151W
574459N	1554557W
574011N	1555510W
573238N	156 448W
573034N	1562123W
572816N	1562625W
572535N	1563046W
571144N	1564452W
57 715N	1564812W
57 1 0N	15711 8W
5657 0N	158 659W
565614N	1581145W
565127N	158 740W
564838N	1575445W
564149N	1575455W
563814N	158 643W
563438N	1581012W
563314N	1582110W
563050N	1583543W
563236N	1584115W
563153N	1584625W
561546N	159[illegible]938W
561418N	1592142W
561319N	1591757W
561113N	1592615W
56 133N	1593529W
56 040N	1594723W
555643N	1595819W
555448N	160 234W
5552 7N	160 548W
5547 3N	160 624W
554246N	16011 2W
554226N	1602153W
554327N	1602717W
554253N	16032 3W
554037N	16037 8W
553811N	1603943W
553640N	1604314W
553819N	1605938W
553827N	1611255W
552731N	1615118W
552459N	1615351W
552227N	162 859W
551451N	162 857W
5511 5N	1621647W
55 438N	16249 7W
545838N	163 445W
545548N	163 742W
545327N	1631410W
544937N	16320 1W
5448 9N	1633530W
544610N	16344 4W
544525N	1635815W
544420N	164 917W
544412N	1642334W
544043N	1642842W
5437 3N	1642730W
543418N	1644127W
543256N	16448 2W
541735N	1653036W
5415 9N	1653932W
541134N	16554 5W
54 8 3N	1655917W
535817N	1664055W
535731N	1664714W
535644N	1665358W
535315N	1665511W
5352 2N	1664822W
535010N	1663830W
534526N	1663955W
534034N	1663846W
533857N	1664124W
5336 1N	1664723W
533425N	1665041W
533056N	1665954W
532648N	167 540W
532439N	1671056W
521241N	1672035W
532028N	1672747W
532038N	1673322W
531927N	1674517W
532228N	168 328W
532315N	1681352W
5318 0N	1681731W
53 922N	1683214W
53 737N	1684128W
525029N	1694519W
524025N	1695648W
524439N	170 649W
523915N	1703934W
523631N	1704711W
523427N	171 817W
522957N	1711515W
521925N	1722113W
5219 7N	1723050W
521627N	1723450W
52 527N	173 313W
52 513N	173 736W
52 512N	17316 2W
52 5 8N	1732617W
52 532N	1733425W
52 817N	1733742W
52 449N	1734454W
52 442N	1734841W
521840N	174 129W
522246N	174 932W
521949N	174 8 5W

LATITUDE	*LONGITUDE*
52 9 8N	1741515W
52 648N	1742959W
52 3 5N	1744417W
52 315N	1745646W
52 1 9N	175 238W
52 244N	1751026W
52 117N	1751849W
5159 3N	1752643W
515727N	1754314W
515649N	1754756W
515833N	1755413W
52 429N	176 622W
52 218N	176 711W
515220N	176 157W
514938N	17613 2W
515119N	17618 5W
515116N	1762119W
515019N	1762842W
515614N	1764416W
515526N	177 927W
514953N	1774113W
514921N	1775618W
515159N	178 123W
515311N	178 826W
514724N	1784731W
515523N	17941 9E
5158 6N	1794036E
5159 4N	1793614E
515720N	1783210E
52 057N	178 817E
52 6 9N	1773642E
52 135N	1773343E
515813N	17729 5E
515654N	1772225E
515524N	1771929E
515411N	1771743E
522053N	1755513E
5230 0N	1734314E
5229 7N	17341 4E
522842N	1733842E
522731N	1733449E
525030N	1732514E
525214N	173 330E
525337N	1725912E
5256 1N	1724449E
525729N	1724122E
525527N	1723132E

(f) *Exempt royalty oil*—(1) *General rule.* The term "exempt royalty oil" means with respect to a qualified royalty owner (as defined in paragraph (f)(2) of this section) that portion of such owner's qualified royalty production (as defined in paragraph (f)(3) of this section) for a calendar quarter that does not exceed the royalty limit (as defined in paragraph (f)(4) of this section) for the quarter.

(2) *Qualified royalty owner.* The term "qualified royalty owner" means a producer (within the meaning of section 4996(a)(1)), but only if the producer is:

(i) An individual

(ii) An estate, or

(iii) A qualified family farm corporation (within the meaning of section 6429(d)(4)).

The term does not include a trust. However, in the case of a grantor trust (*i.e.*, a trust where the grantor or another person is treated a substantial owner of the trust under subpart E of subchapter J of chapter 1 of the Code), the person or entity who is treated as substantial owner may qualify if such person or entity is an individual, an estate, or a qualified family farm corporation.

(3) *Qualified royalty production*—(1) *General rule.* The term "qualified royalty production" means, with respect to any qualified royalty owner, crude oil removed after December 31, 1981, which would be taxable crude oil (within the meaning of section 4991(a)) except for the exemption in section 4991(b)(5) and which is attributable to an economic interest of such royalty owner other than an operating mineral interest (within the meaning of section 614(d)).

(ii) *Exclusion for certain interests created after June 9, 1981.* The term "qualified royalty production" does not include crude oil attributable to any overriding royalty interest, production payment, net profits interest, or similar interest of the qualified royalty owner which:

(A) Is created after June 9, 1981, out of an operating mineral interest in property which is a proven oil or gas property (within the meaning of section 613A(c)(9)(A)) on the date such interest is created, and

(B) Is not created pursuant to a binding written contract (including an irrevocable written option) entered into before June 10, 1981.

The exclusion in this subdivision, however, does not apply to a landowner that retains a royalty on a lease of a proven property owned by such landowner.

(iii) *Exclusion for production from certain transferred properties*—(A) *In general.* In the case of a transfer of an interest in any property, the qualified royalty production fo the transferee shall not include any production attributable to an interest that has been transferred after June 9, 1981, in a transfer which is described in section 613A(c)(9)(A). For the purpose of the preceding sentence, a transfer includes a sublease and property held by an estate shall be treated as owned both by the estate and proportionately by the beneficiaries of the estate.

(B) *Exception for certain transfers at death or among certain related persons.* The transfer rule of paragraph (f)(3)(iii)(A) of this section does not apply to any transfer described in section 613A(c)(9)(B) (relating to certain transfers at death or among certain related persons).

(C) *Exception for certain transfers where the transferor and the transferee are required to share the royalty limit.* The transfer rule of paragraph (f)(3)(iii)(A) of this section shall not apply to any transfer so long as the transferor and the transferee are required to share the royalty limit in accordance with the rules of paragraph (f)(4) of this section, but only if the production from the property was qualified royalty production of the transferor.

(4) *Royalty limit*—(i) *In general.* A qualified royalty owner's qualified royalty production is determined by applying section 4994(f)(2)(A).

(ii) *Production exceeds limitation.* If a qualified royalty owner's qualified royalty production for any quarter exceeds the royalty limit in section 4994(f)(2)(A) for such quarter, the royalty owner may allocate the royalty limit for such quarter to any qualified royalty production that the royalty owner selects.

(iii) *Allocation of royalty limit among taxpayers.* For the purpose of allocating the royalty limit in section 4994(f)(2)(A) among taxpayers, section 6429(c)(2) thru (4) will be applied except that the royalty limit determined under section 4994(f)(2)(A) is substituted in place of $2,500 each time it appears in section 6429(c)(2) thru (4).

(g) *Exempt stripper well oil.* [Reserved]

Par. 3 Paragraph (b)(1) of §51.4995-2 is revised to read as follows:

§51.4995-2 Producer's certificate.

* * * * *

(b) *Exemption certificate*—(1) *In general.* For purposes of this section, an exemption certificate is a written statement certifying that all of the producer's crude oil from a property is exempt from the tax imposed by section 4986 because the crude oil constitutes

exempt Indian oil or exempt royalty oil or the oil is from a qualified governmental interest or a qualified charitable interest. In the case of a trust or estate described in paragraphs (b)(4) or (c)(3) of §51.4994-1, the exemption certificate may certify that a percentage of the oil from that property is exempt from the tax imposed by section 4986 because that portion of the oil is oil from a qualified charitable or governmental interest. The percentage referred to in the preceding sentence may be based on a reasonable estimate of the percentage of the oil from the property that is held for the benefit of a qualified charity or governmental unit for that taxable period. Any producer who furnishes an exemption certificate (other than an exempt royalty owner's certificate) to an operator, purchaser, partnership, or other disburser shall also file an exemption certificate with the Internal Revenue Service Center, Austin, Texas. Only one such certificate need be filed even though the producer may furnish certificates to more than one operator, purchaser, partnership, or other disburser.

* * * * *

Par. 4. Paragraph (b)(2) of §51.4996-1 is revised to read as follows:

§51.4996-1 Definitions.

* * * * *

(b) *Producer* * * *

(2) *Partnerships, trusts, and estates.* In the case of a partnership, the partnership's economic interest in the crude oil shall be allocated among the partners on the basis of each partner's proportionate share of the partnership's income from the crude oil, and the partner to whom the crude oil is allocated shall be treated as the producer of the crude oil. In the case of a trust other than a grantor trust, *i.e.*, a trust where the grantor or another person is treated as substantial owner of the trust under subpart E of subchapter J of chapter 1 of the Internal Revenue Code) or an estate, the entity is the producer rather than the beneficiaries. In the case of a grantor trust, to the extent that a person or entity (the grantor or another person) is treated for purposes of income taxation under subchapter J of chapter 1 of the Internal Revenue Code as the owner of a crude oil interest held by such trust, such person or entity shall be deemed to be the producer of the crude oil attributable to such interest for purposes of section 4996(a)(1). (See also §51.4994-1 for special rules concerning the treatment of trusts and estates for purposes of determining the applicability of certain exemptions from the windfall profit tax.)

* * * * *

Par. 5. The authority for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805. * * *

Par. 6. Paragraph (c) of existing §602.101(c) is amended by inserting in the appropriate places in the table §51.4995-2(b)(1) . . . 1545-0912".

JAMES I. OWENS,
Acting Commissioner of Internal Revenue.

Approved August 30, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on October 7, 1985, 8:45 a.m., and published in the issue of the Federal Register for October 8, 1985, 50 F.R. 40966)

Subchapter C.—Miscellaneous Provisions

Section 4995.—Withholding; Depositary Requirements

26 CFR 51.4995-2: Producer's certificate.

Definitions relating to exceptions from the windfall profit tax. See T.D. 8056, page 281.

Section 4996.—Other Definitions and Special Rules

26 CFR 51.4996-1: Definitions.

Definitions relating to exemptions from the windfall profit tax. See T.D. 8056, page 281.

Section 4997.—Records and Information; Regulations

26 CFR 51.4997-2: Certain information to be furnished by producers and others.

Credit or refund of windfall profit tax paid by a trust. See T.D. 8055, page 278.

Subtitle F.—Procedure and Administration
Chapter 61.—Information and Returns
Subchapter A.—Returns and Records
Part I.—Records, Statements, and Special Returns

Section 6001.—Notice or Regulations Requiring Records, Statements, and Special Returns

26 CFR 1.6001-1: Records.

Whether the provision of diagnostic laboratory testing services by health organizations exempt from federal income tax under section 501(c)(3) of the Code is unrelated trade or business within the meaning of section 513. See Rev. Rul. 85-110, page 166.

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26 CFR 41.6001-1: Records.

Imposition of tax on use of heavy vehicles and credits and refunds of tax on sale of diesel fuel. See T.D. 8027, page 263.

Part II.—Tax Returns or Statements
Subpart A.—General Requirements

Section 6011.—General Requirement of Return, Statement, or List

26 CFR 1.6011-1: General requirement of return, statement, or list.

Requirements and conditions under which Forms 1042S withholding information returns may be filed on magnetic tape. See Rev. Proc. 85-53, page 721.

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26 CFR 48.6011(a)-1: Returns.

Liability for tax imposed under section 4041, 4042 or 4051 or chapter 32 of the Code shall be reported on Form 720. See T.D. 8043, page 214.

Subpart B.—Income Tax Returns

Section 6012.—Persons Required to Make Returns of Income

26 CFR 1.6012-1: Individuals required to make returns of income.

Adjusted income tax return exemption amount set forth for taxable years beginning in 1986. See Rev. Proc. 85-55, page 737.

Section 6013.—Joint Returns of Income Tax by Husband and Wife

26 CFR 1.6013-2: Joint return after filing separate return.

Adjusted income tax return exemption amount set forth for taxable years beginning in 1986. See Rev. Proc. 85-55, page 737.

Part III.—Information Returns
Subpart A.—Information Concerning Persons Subject to Special Provisions

Section 6033.—Returns by Exempt Organizations

26 CFR 1.6033-2: Returns by exempt organizations; taxable years beginning after December 31, 1969.

Whether the provision of diagnostic laboratory

testing services by health organizations exempt from federal income tax under section 501(c)(3) of the Code is unrelated trade or business within the meaning of section 513. See Rev. Rul. 85-110, page 166.

Section 6035.—Returns of Officers, Directors, and Shareholders of Foreign Personal Holding Companies

26 CFR 1.6035-1: Returns of U.S. officers, directors and 10-percent shareholders of foreign personal holding companies for taxable years beginning after September 3, 1982.
(Also Section 6679; 301.6679-1.)

T.D. 8028

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; SUBCHAPTER F, PART 301—PROCEDURE AND ADMINISTRATION; PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Information Returns Required by Officers, Directors and Shareholders of Foreign Personal Holding Companies

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the amendments made to the Internal Revenue Code of 1954 by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) [Pub. L. 97-248, 1982-2 C.B. 462] which concern information returns required of officers, directors, and shareholders of foreign personal holding companies. While the changes expanded the number of persons required to file information returns for foreign personal holding companies, they also simplified the reporting requirements with respect to foreign personal holding companies and gave the Secretary the authority to set the return due dates and to waive duplicative filings. TEFRA also provided a new $1,000 civil penalty for failure to file a proper and timely foreign personal holding company information return.

DATES: The amendments are effective July 5, 1985 30 days after their publication as a Treasury decision in for taxable years of foreign corporations beginning after September 3, 1982. Taxpayers who are required to file under section 340 of TEFRA and who have compiled information based on the old Forms 957 and 958, which were replaced by Form 5471, may file the old forms instead of Form 5471 for taxable years ending on or before November 30, 1983. (See Announcement 83-56, 1983-13 I.R.B. 92).

FOR FURTHER INFORMATION CONTACT: Marnie J. Carro of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington D.C. 20224, (Attention: CC:LR:T) (202-566-3289, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On September 6, 1984, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 6035 and the Regulations on Procedure and Administration (26 CFR 301) under section 6679 of the Internal Revenue Code of 1954 (49 FR 35145) [LR-200-82, 1984-2 C.B. 856]. These amendments were proposed to conform the regulations to changes made to sections 6035 and 6679 by Section 340 of TEFRA (96 Stat. 633, 634) [Pub. L. 97-248, 1982-2 C.B. 462, 578]. A public hearing was neither requested nor held. One public comment was received. After consideration of this comment, the regulations are being published as they appeared in the notice of proposed rulemaking except for minor clarifying changes.

TEFRA simplified the reporting requirements that section 6035 imposes with respect to foreign personal holding companies. Prior to its amendment, section 6035 and the regulations thereunder required U.S. officers and directors of foreign personal holding companies to file two annual returns.

The first information return was filed on Form 957 and concerned the stock structure and identity of the shareholders of the corporation. The second information return was filed on Form 958 and concerned the foreign personal holding company's income and deductions for the taxable year, as well as undistributed foreign personal holding company income. In addition, any U.S. shareholder who had not already filed as a director or officer and who held 50% or more of the corporation's stock was required to file Form 957.

Because the various returns of officers, directors, and 50% shareholders suffered from overlapping coverage, as well as inconveniently staggered filing dates; TEFRA combined the filing requirements and gave the Service flexibility in setting return due date and waiving duplicative filings. Forms 957 and 958 have now been incorporated into Form 5471. TEFRA also expanded its reporting requirements to each United States citizen or resident who is a 10-percent (rather than 50-percent) shareholder of a foreign personal holding company as well as to officers and directors who are U.S. citizens or residents.

The regulations provide that Form 5471 is to be filed with the income tax return of the person required to file. In addition, the regulations provide that one person may file Form 5471 and the applicable schedules for other persons who have the same filing requirements. A person who does not file Form 5471 because another person has agreed to file the information on his behalf must attach a statement to his return identifying such person and he still remains liable under the penalty provisions if that other person fails to file a proper return.

Information required by the regulations includes corporate, shareholders and income information. The required shareholder information includes the names and addresses of all persons who held shares, options, and convertible securities during the taxable year; a description of each class of shares and the total number of shares of each class outstanding at the beginning and end of the taxable year; the number of shares of each class, option, or convertible security held by each person; and any changes in the holdings of shares, options, or convertible securities during the year. Required income information includes the foreign personal holding company's gross income, deductions, credits, taxable income, and undistributed foreign personal holding company income for the year.

In addition to the criminal penalties imposed by existing law for failure to file a return and filing a false or fraudu-

lent return. TEFRA imposed by an amendment under section 6679 a $1,000 civil penalty for failure to file a proper foreign personal holding company information return. This penalty does not apply, however, if the failure is shown to be due to reasonable cause.

DISCUSSION OF COMMENT

Under §1.6035-1(b)(2)(ii) and (b)(4) as proposed, an individual who does not own 10 percent or more in value of the outstanding stock directly, but is required to file solely by attribution of another United States person's stock ownership, is excused from filing if the direct owner who is an individual furnishes all the information required. The excused filer is required to file a statement with his income tax return indicating that such requirement has been or will be satisfied. In this context, the comment suggested that the regulations exempt from the filing requirements all individuals who directly own no stock of a foreign corporation. The final regulations do not adopt this suggestion because the statute requires that any individual who owns directly or *indirectly* 10 percent or more in value of the outstanding stock of a foreign corporation file a foreign personal holding company information return.

CERTIFICATION OF NONAPPLICABILITY OF REGULATORY FLEXIBILITY ACT OF 1980 AND EXECUTIVE ORDER 12291

The Secretary of the Treasury has certified that these regulations will not have a significant economic impact on a substantial number of small entities and are, therefore, not subject to the requirements of the Regulatory Flexibility Act of 1980 (5 U.S.C. chapter 6). Accordingly, a Regulatory Flexibility Analysis is not required and has not been prepared. The Commissioner of Internal Revenue has determined that these regulations are not major regulations subject to Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required and has not been prepared.

PAPERWORK REDUCTION ACT

The collection of information contained in these regulations has been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these regulations is Marnie J. Carro of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1, Part 301, and Part 602 are amended as follows:

Paragraph 1. These regulations are issued under the authority contained in 26 U.S.C. 7805 and 26 U.S.C. 6035(a), (d), and (e). The authority citation for Part 1 is amended by adding, "§§1.6035-1 through -3 also issued under 26 U.S.C. 6035(a), (d), and (e)."

Par. 2. Section 1.6035-1 is revised to read as follows:

§1.6035-1 Returns of U.S. officers, directors and 10-percent shareholders of foreign personal holding companies for taxable years beginning after September 3, 1982.

(a) *Requirements of returns—(1) In general.* For taxable years of a foreign personal holding company beginning after September 3, 1982, each United States citizen or resident who is an officer, director, or 10-percent shareholder of the foreign personal holding company (as defined in section 552) shall file with his income tax return, on or before the date that return is due, form 5471 and the applicable schedules to be completed in accordance with the instructions setting forth corporate, shareholder, and income information for the foreign personal holding company's annual accounting period that ends with or within the officer's, director's, or shareholder's taxable year.

(2) *General corporate information.* The general foreign personal holding company information required by this section with respect to each taxable year is as follows:

(i) The name and address and employer identification number (if any) of the corporation;

(ii) The kind of business in which the corporation is engaged;

(iii) The date of its incorporation;

(iv) The country under the laws of which the corporation is incorporated;

(v) A description of each class of stock issued and outstanding by the corporation for the beginning and end of the annual accounting period;

(vi) The number of shares and par value of common stock of the corporation issued and outstanding as of the beginning and end of the taxable year;

(viii) The number of shares and par value of preferred stock of the corporation issued and outstanding as of the beginning and end of the taxable year, the rate of dividend on such stock and whether such dividend is cumulative or noncumulative; and

(viii) Any other information required by the appropriate form and its instructions.

For purposes of this paragraph, the term "share" includes any security convertible into a share in the corporation and any option granted by the corporation with respect to any share in the corporation.

(3) *Shareholder information.* The shareholder information required by this section is as follows:

(i) The name, address and taxpayer identification number (if any) of each person, whether foreign or U.S., who was a shareholder during the taxable year and the class and number of shares held by each, together with an explanation of any changes in stock holdings during the taxable year;

(ii) The name and address of each holder during the taxable year of securities convertible into stock of the corporation and the class, number, and face value of the securities held by each, together with an explanation of any changes in the holdings of such securities during the taxable year;

(iii) The name and address of each holder during the taxable year of any option granted by the corporation with respect to any share in the corporation, and a full description of the options held by each, together with an explanation of any changes in the holdings of such options during the taxable year, and

(iv) Any other information required

by the appropriate form and its instructions.

(4) *Income information.* The income information required by this section is the gross income, deductions and credits, taxable income, foreign personal holding company income, and undistributed foreign personal holding company income for the taxable year and other information required by the appropriate form and its instructions.

(b) *Persons required to file return*—(1) *In general.* The determination of whether a United States citizen or resident is a person who is an officer, director, or 10-percent shareholder required to file a return with respect to any foreign corporation is made as of the date that Form 5471 is required to be filed. If there is no such person required to file on that date (because, for example, the corporation has been dissolved), then filing is required of the persons who were officers, directors or 10-percent shareholders on the last day of the most recent taxable year of the corporation for which there was such a person who was a United States citizen or resident.

(2) *10-percent shareholder.* (i) the term "10-percent shareholder" means any individual who owns directly or indirectly (within the meaning of section 554) 10 percent or more in value of the outstanding stock of a foreign corporation.

(ii) An individual who does not own 10 percent or more in value of the outstanding stock directly but is required to file solely by attribution of another United States person's stock ownership is excused from filing if the direct owner that is an individual furnishes all the information required.

(3) *Two or more persons required to submit the same information.* If two or more persons are required to furnish the information for the same foreign personal holding company for the same period, one person may make one return on Form 5471. The single Form 5471 may be filed with the income tax return of any one of the persons and shall disclose the name, address, and identifying number of each other person or persons on whose behalf the return is filed. Each person on whose behalf the return is filed remains liable for any penalties imposed under sections 6679, 7203, 7206, and 7207.

(4) *Statement required.* Any United States citizen or resident required to furnish information under this section with his return who does not do so by reason of the provisions of subparagraph (2)(ii) or (3) of this paragraph shall file a statement with his income tax return indicating that such requirement has been or will be satisfied and identifying the return with which the information was or will be filed and the place of filing.

(c) *Separate returns for each corporation.* If a person is required to file returns under section 6035 and this section with respect to more than one foreign personal holding company, separate returns must be filed with respect to each company.

(d) *Corrective filing.* If an information return with respect to a taxable year of a foreign personal holding company beginning after September 3, 1982, is filed before [date which is 30 days after the date of publication of a Treasury decision in the Federal Register] and that return does not contain all of the information required by this section, then the filer of the return shall file an amended information return containing all of such information within 90 days after [date of publication of a Treasury decision in the Federal Register].

(e) *Penalties*—(1) *Criminal penalties.* For criminal penalties for failure to file a return and filing a false or fraudulent return, see sections 7203, 7206, and 7207.

(2) *Civil penalties.* For civil penalties for failure to file a proper foreign personal holding company information return, see section 6679 and the regulations thereunder.

Par. 3. Section 1.6035-2 is revised to read as follows:

§1.6035-2 Returns of U.S. officers and directors of foreign personal holding companies for taxable years beginning before September 4, 1982.

For rules relating to information returns required to be filed by officers and directors of foreign personal holding companies for taxable years beginning before September 4, 1982, see section 6035(a) (as in effect before the enactment of the Tax Equity and Fiscal Responsibility Act of 1982) and 26 CFR 1.6035-1 (Rev. as of April 1, 1981).

Par. 4. Section 1.6035-3 is revised to read as follows:

§1.6035-3 Returns of 50-percent U.S. shareholders of foreign personal holding companies for taxable years beginning before September 4, 1982.

For rules relating to information returns required to be filed by shareholders of foreign personal holding companies for taxable years by beginning before September 4, 1982, see section 6035(b) (as in effect before the enactment of the Tax Equity and Fiscal Responsibility Act of 1982) and 26 CFR 1.6035-2 [Rev. as of April 1, 1981].

Par. 5. The authority citation for Part 602 is as follows:

Authority: 26 U.S.C. 7805.

Par. 6. Section 602.101(c) is amended by inserting in the appropriate place in the table "§1.6035-1 ... 1545-0704" "§1.6035-2 ... 1545-0704".

Par. 7. The authority citation for part 301 is unchanged. Section 301.6679-1 relies for authority on 26 U.S.C. 7805.

Par. 8. Section 301.6679-1 is amended as follows:

1. The section heading is revised to read as follows: "Failure to file returns, etc. with respect to foreign corporations or foreign partnerships for taxable years beginning after September 3, 1982".

2. Paragraph (a)(1) is revised as set forth below.

3. Paragraph (a)(2) is amended by removing "section 6046 and §1.6046-1," and adding in its place "section 6035, 6046, or 6046A".

4. The third sentence of paragraph (a)(3) is amended by removing "section 6046" and adding in its place 'section 6035, 6046, or 6046A".

§301.6679-1 Failure to file returns, etc. with respect to foreign corporations or foreign partnerships for taxable years beginning after September 3, 1982.

(a) *Civil penalty*—(1) *In general.* In addition to any criminal penalty provided by law, each United States citizen, resident or person filing a separate or joint information return or on whose behalf a return is filed, pursuant to sections 6035, 6046, or 6046A, and the regulations thereunder, who fails to file such a return within the time provided, or who files a return which does not

ıow the required information, shall ıy a penalty of $1,000, unless such ilure is shown to be due to reasonable ıuse.

* * * * *

This Treasury decision is issued un-er the authority contained in Code sec-ons 6035(a), (d), and (e) (96 Stat. 33, 26 U.S.C. 6035(a), (d), and (e)), 679 (96 Stat. 634; 26 U.S.C. 6679), nd 7805 (68a Stat. 917, 26 U.S.C. 805). Approved by the Office of Man-gement and Budget under control umber 1545-0704.

JAMES I. OWENS,
Acting Commissioner of Internal Revenue.

Approved May 20, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 3, 1985, 8:45 a.m., and published in the issue of the Federal Register for June 4, 1985, 50 F.R. 23407)

Section 6038.—Information With Respect to Certain Foreign Corporations

26 CFR 1.6038-2: Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations beginning after December 31, 1962. Also Section 6038A; 1.6038A-1.)

T.D. 8040

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Information Returns Required of Certain Foreign-owned Corporations, and Information Returns Required of United States Persons With Respect to Certain Foreign Corporations

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final Income Tax Regulations relating to information returns required of United States persons with respect to certain foreign corporations, and information returns required of certain foreign-owned corporations with respect to transactions with related corporations, under sections 6038 and 6038A, respectively, of the Internal Revenue Code of 1954. These regulations set forth the requirements for who must report, the information required to be reported, the time and manner for filing the information returns, and penalties for failure to report information. Changes to the applicable tax law were made by the Tax Equity and Fiscal Responsibility Act of 1982. These regulations provide the public with the guidance needed to comply with that Act.

DATES: The amendments under section 6038 with respect to penalties are effective for information required with respect to annual accounting periods of the foreign corporations ending after September 3, 1982. The remaining amendments under section 6038 are effective for taxable years beginning after August 23, 1985. The amendments under section 6038A are effective for taxable years beginning after December 31, 1983.

FOR FURTHER INFORMATION CONTACT: Charles C. Saverude of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, (Attention: CC:LR:T) (202-566-3323, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On December 19, 1983, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 6038 and 6038A of the Internal Revenue Code of 1954 (48 F.R. 56076) [LR-201-82, 1984-1 C.B. 752]. These amendments were proposed to conform the regulations to changes made to section 6038 and the addition of section 6038A by sections 338 and 339 of the Tax Equity and Fiscal Responsibility Act of 1982 (96 Stat. 631) [Pub. L. 97-248, 1982-2 C.B. 462, 576, 577]. A public hearing was held on March 29, 1984. After consideration of all comments regarding the proposed amendments, the amendments as set forth below are adopted by this Treasury decision.

DISCUSSION OF COMMENTS AND CHANGES FROM PROPOSED AMENDMENTS

Sections 1.6038-2 and 1.6038A-1

Two commentors suggested that a reporting person who has "substantially complied" with the reporting rules should not be penalized for errors or omissions. In both §1.6038-2 and §1.6038A-1, an explicit statement to that effect is not needed because "substantial compliance," as well as other factors, may be considered in determining whether reasonable cause existed for failure to furnish some information if a penalty for such a failure is asserted. However, a provision relating to "substantial compliance" has been retained, slightly modified for clarification, in §1.6038-2(k)(3), and the same language has been added to §1.6038A-1(f)(3)(ii) for foreign-owned corporations. The Service anticipates that the broad range of estimates and descriptions allowed in §1.6038A-1 for reporting of transactions will prevent most inadvertent errors from causing a technical violation if the reporting corporation has made a reasonable effort to comply.

The filing requirements for information returns under sections 6038 and 6038A have also been changed to require that duplicate returns be filed with the Philadelphia Service Center. This will facilitate use of the information in a centralized statistical analysis program (in addition to its use in audits), without the delays and additional costs to the Service of sorting, duplicating, and transferring the information received in the regional service centers for a second use in Philadelphia.

Section 1.6038-2

One comment criticized the proposal to allow other information to be required by forms. The commentor suggested that any requirement to provide additional information should be subject to notice and public comment procedures. The regulation has been modified to allow changes in the form or manner in which the prescribed information is to be reported, or to allow some items of information to be de-

leted, by the form, without allowing the form to require additional information.

Section 1.6038A-1

Changes have been made in paragraphs (a) and (b) to allow a group of corporations filing a consolidated income tax return to file Form 5472 on a consolidated basis, and to eliminate reporting with respect to transactions within the group. However, a reporting corporation (or group) is still required to file separately with respect to each related corporation with which it has transactions. Two commentors suggested that it might be easier to file one form (or one computer listing) for all related-corporation transactions, with details attached on a company-by-company basis is necessary. In the Service's view, adoption of that suggestion would not significantly reduce any burden of compliance, but it would reduce the usefulness of the information to the Service.

Two commentors suggested that the Service not require annual reporting of information, but rather collect it on a sample basis. This suggestion has not been adopted. Other commentors suggested that information reporting should not be required under section 6038A when a transaction must also be reported under section 6038. This suggestion has been adopted in paragraph (a)(3).

Paragraph (b)(1), defining "reporting corporation," contains an exception from reporting for corporations having no income subject to U.S. taxation. Several commentors felt that the exception should be clarified and expanded in various ways. That exception has been revised to include more situations in which reporting may not be particularly useful to the Internal Revenue Service. Banks are now excepted from reporting, as are other foreign corporations having no income except income subject to withholding or exempt from tax under the provisions of an income tax treaty.

A sentence has been added to the example in paragraph (b)(2), defining control, to explain that control is attributed directly rather than proportionately, once the 50 percent ownership threshold is met.

Paragraph (b)(3) has been changed to clarify that the term "foreign person" includes a foreign government or government agency.

The definition of "related corporation" has been narrowed to eliminate reporting of transactions between corporations that join in filing a consolidated income tax return.

In paragraph (c)(1), several items of information concerning the related corporation have been deleted in response to comments that the information required was overly burdensome or not readily available to the reporting corporation. All of the items of information listed in the proposed regulations were carefully considered, and those items that are retained have been determined to be the information most necessary to the Internal Revenue Service. One commentor suggested that some of the required information may be unavailable to the reporting corporation. Inability to obtain information may be reasonable cause for failure to provide that information. If the reporting corporation shows reasonable cause for failure to provide any information, paragraph (f)(3) provides procedures for avoiding imposition of penalties.

Paragraph (c)(2) has been revised to allow the form to change the manner in which information is reported without allowing it to require new information.

In response to comments that the reporting of transactions in exact amounts would be extremely burdensome, unnecessary, and subject to potentially severe penalties for minor errors, paragraph (c)(2) has been revised to allow reporting by reasonable estimates. The term "reasonable estimate" is defined in paragraph (c)(2)(iv), providing permissible percentages of variation and a simple method for reporting small amounts, as well as allowing a reporting corporation to show by facts and circumstances that its estimates were reasonable, if not within the ranges provided.

Two comments suggested that more types of reportable service transactions were listed in paragraph (c)(2)(i)(E) than in §1.6038-2(f)(11)(iv), producing a reporting burden that would discriminate against foreign-owned corporations in violation of income tax treaties. While the Service does not agree that the difference in reporting requirements would violate income tax treaty provisions, this item has nonetheless been changed to duplicate the services listed in §1.6038-2 to avoid any appearance of discrimination.

One commentor requested that the regulations provide guidance with respect to the method for reporting amounts loaned or borrowed. In response to this, a new sentence has been added at the end of paragraph (c)(2)(i) to provide a method for reporting those amounts, and to allow that method to be changed by forms.

A suggestion that banking transactions entered into on behalf of customers should be excluded form the information to be reported has not been adopted because banks have been excluded from reporting in general. A similar suggestion was made to exclude transactions by brokers and insurance companies on behalf of customers. This suggestion has not been adopted.

The requirements in paragraph (c)(2)(ii) for reporting transactions involving non-monetary consideration or no consideration have been revised to allow more flexibility in the manner in which transactions may be described. A description may be provided for a single transactions or a group of similar or related transactions. While a description should include all property and services transferred, the essential requirement is that it include sufficient information from which to determine the substance and size of the transaction. In reporting the value of these transactions, the reasonable estimate rules (discussed above) apply. These liberalized requirements are intended to permit one fairly brief description to be used to report a pattern of transactions for which no individual records are kept because the transactions are considered too insignificant to require compensation or because they are performed on a reciprocal basis. Also, a sentence has been added at the end of paragraph (c)(2)(ii) to clarify that descriptions of transactions under that subdivision are not required merely because the transaction involves a transfer of some intangible property in connection with tangible property for which monetary consideration is paid or received. A transaction fitting that description may be reported under paragraph (c)(2)(i), which only requires the reporting of a dollar amount.

In paragraph (c)(2)(iii), the exception for transactions that are not required to be reported has also been expanded and simplified, and now includes nonrecognition transactions, such as like-kind exchanges under section 1031.

Two comments stated that reporting of amounts in U.S. dollars, with exchange rates used, would be irrelevant, unnecessary and unduly burdensome in light of constantly changing exchange rates. It is precisely because of changing exchange rates that the rates used are relevant and necessary. Since a rate of exchange must be used in order to translate one currency into another, the reporting corporation will always have this information.

One commentor suggested that these information returns should not be due until 6 months after the reporting corporation's income tax return is filed. The information returns are required to be filed with the income tax return because they will be used with the income tax return to determine certain areas for which closer examination may be appropriate during an audit. Separate filing would require the Internal Revenue Service to match these information returns with the reporting corporation's tax returns. Therefore, the suggestion has not been adopted.

A few commentors proposed that no reporting should be required for past years, or that reports for those years should be made in an abbreviated fashion. These final regulations require reporting for all taxable years beginning after December 31, 1983. Reporting is not required for taxable years beginning before January 1, 1984. The reasonable estimate rule for reporting amounts of transactions should help to reduce the burden of compiling information on past transactions. Information returns for taxable years ending before July 24, 1985 must be filed by November 21, 1985, or, if later, with the reporting corporation's tax return for the same taxable year.

Paragraph (f)(1) has been revised to clarify that the penalty for failure to furnish information only applies once with respect to each related corporation for each year that a report is required. Suggestions that a "substantial compliance" exception should be added to the penalty provisions have been adopted, as discussed previously. In addition, the "reasonable estimate" provisions of the reporting requirements operate, in effect, quite similarly to the substantial compliance provision to prevent imposition of a penalty if a reporting corporation has complied with those requirements. Another commentor suggested that the regulations should provide specific guidelines for determining reasonable cause for failing to provide information, for the purpose of avoiding the penalty provided. For example, the comment suggested that a reporting corporation would not know and would not be able to determine whether it was dealing with a related corporation, and therefore the regulations should provide rules specifically excepting that reporting corporation from the penalty provisions. The final regulations do not include any specific guidelines or exceptions for determining whether a failure to provide information was due to reasonable cause. This determination must be based on the facts and circumstances of each individual case. Specific guidelines may be helpful in some cases but not in others because a failure may be due to reasonable cause under some facts but not under other similar facts.

CERTIFICATION OF NONAPPLICABILITY OF REGULATORY FLEXIBILITY ACT OF 1980 AND EXECUTIVE ORDER 12291

The Secretary of the Treasury has certified that these regulations will not have a significant economic impact on a substantial number of small entities and are, therefore, not subject to the requirements of the Regulatory Flexibility Act of 1980 (5 U.S.C. chapter 6). Accordingly, a Regulatory Flexibility Analysis is not required and has not been prepared. These regulations will generally only affect United States persons that have significant holdings in foreign corporations and certain foreign-owned corporations that have transactions with related corporations. The Commissioner of Internal Revenue has determined that these regulations are not major regulations subject to Executive order 12291. Accordingly, a Regulatory Impact Analysis is not required and has not been prepared.

PAPERWORK REDUCTION ACT

The collection of information contained in these regulations has been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB under control number 1545-0805.

DRAFTING INFORMATION

The principal author of these regulations is David J. Dean of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1, Part 301, and Part 602 are amended as following:

Income Tax Regulations

Paragraph 1. These regulations are issued under the authority contained in 26 U.S.C. 7805, 26 U.S.C. 6038 and 26 U.S.C. 6038A. The authority citation for Part 1 is amended by adding, "§1.6038-2 and §1.6038A-1 also issued under 26 U.S.C. 6038 and 6038A."

Par. 2. Section 1.6038-2 is revised to read as follows:

§1.6038-2 Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations beginning after December 31, 1962.

(a) *Requirement of return.* Every U.S. person shall make a separate annual information return with respect to each annual accounting period (described in paragraph (e) of this section) beginning after December 31, 1962, of each foreign corporation which that person controls (as defined in paragraph (b) of this section) for an uninterrupted period of 30 days or more during such annual accounting period. Such information shall not be required to be furnished, however, with respect to a corporation defined in sec-

tion 1504(d) of the Code which makes a consolidated return for the taxable year. The return shall be made, with respect to annual accounting periods ending with or within the United States person's taxable year, on—

(1) Form 2952 if such taxable year ends before December 31, 1982,

(2) Form 5471 if such taxable year ends on or after December 31, 1983, or

(3) Either Form 5471 or Form 2952 if such taxable year ends on or after December 31, 1982 and before December 31, 1983.

(b) *Control.* A person shall be deemed to be in control of a foreign corporation if at any time during that person's taxable year it owns stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or more than 50 percent of the total value of shares of all classes of stock of the foreign corporation. A person in control of a corporation which, in turn, owns more than 50 percent of the combined voting power, or of the value, of all classes of stock of another corporation is also treated as being in control of such other corporation. The provisions of this paragraph may be illustrated by the following example:

Example. Corporation A owns 51 percent of the voting stock in Corporation B. Corporation B owns 51 percent of the voting stock in Corporation C. Corporation C in turn owns 51 percent of the voting stock in Corporation D. Corporation D is controlled by Corporation A.

(c) *Attribution rules.* For the purpose of determining control of domestic or foreign corporations the constructive ownership rules of section 318(a) shall apply except that:

(1) Stock owned by or for a partner or a beneficiary of an estate or trust shall not be considered owned by the partnership, estate, or trust when the effect is to consider a United States person as owning stock owned by a person who is not a United States person;

(2) A corporation will not be considered as owning stock owned by or for a 50 percent or more shareholder when the effect is to consider a United States person as owning stock owned by a person who is not a United States person; and

(3) If 10 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, section 318(a)(2)(C) shall apply.

The constructive ownership rules of section 318(a) apply only for purposes of determining control as defined in paragraph (b) of this section.

(d) *U.S. person.* For purposes of section 6038 and this section, the term "United States person" has the meaning assigned to it by section 7701(a)(30) of the Code, except that—

(1) With respect to a corporation organized under the laws of the Commonwealth of Puerto Rico, such term does not include an individual who is a bona fide resident of Puerto Rico, if a dividend received by such individual during the taxable year from such corporation would be excluded from gross income under section 933(1),

(2) With respect to a corporation organized under the laws of the Virgin Islands, such term does not include an individual who is a bona fide resident of the Virgin Islands and whose income tax obligation under subtitle A (relating to income taxes) of the Code for the taxable year is satisfied pursuant to section 28(a) of the Revised Organic Act of the Virgin Islands, approved July 22, 1954 (48 U.S.C. 1642), by paying tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands,

(3) With respect to a corporation organized under the laws of Guam or the Northern Mariana Islands, such term does not include an individual who is a bona fide resident of Guam or the Northern Mariana Islands, respectively, and who is relieved of liability for income tax to the United States under section 935(c)(3) of the Code or section 601 of the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America (Pub. L. 94-241), respectively, for such individual's taxable year referred to in paragraph (e) of this section, and

(4) With respect to a corporation organized under the laws of any possession of the United States (other than Guam, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands), such term does not include an individual who is a bona fide resident of such possession for the entire taxable year and whose income derived from sources within any possession of the United States is not, by reason of section 931(a), includible in gross income under subtitle A (relating to income taxes) of the Code for the taxable year.

An individual for whom an election under section 6013(g) or (h) is in effect shall, subject to the exceptions contained in this paragraph (d), be considered a United States person for purposes of section 6038 and this section.

(e) *Period covered by return.* The information required under paragraphs (f) and (g) of this section with respect to a foreign corporation shall be furnished for the annual accounting period of the foreign corporation ending with or within the United States person's taxable year. For purposes of this section, the annual accounting period of a foreign corporation is the annual period on the basis of which that corporation regularly computes its income in keeping its books. The term "annual accounting period" may refer to a period of less than one year, where, for example, the foreign income, war profits, and excess profits taxes are determined on the basis of an accounting period of less than one year as described in section 902(c)(2). If more than one annual accounting period ends with or within the United States person's taxable year, separate annual information returns shall be submitted for each annual accounting period.

(f) *Contents of return.* the return on Form 2952 or Form 5471 shall contain so much of the following information, and in such form or manner, as the form shall prescribe with respect to each foreign corporation:

(1) The name, address, and employer identification number. If any, of the corporation;

(2) The principal place of business of the corporation;

(3) The date of incorporation and the country under whose laws incorporated;

(4) The name and address of the foreign corporation's statutory or resident agent in the country of incorporation;

(5) The name, address, and identifying number of any branch office or agent of the foreign corporation located in the United States;

(6) The name and address of the person (or persons) having custody of the books of account and records of the foreign corporation, and the location of

such books and records if different from such address;

(7) The nature of the corporation's business and the principal places where conducted;

(8) As regards the outstanding stock of the corporation—

(i) A description of each class of the corporation's stock, and

(ii) The number of shares of each class outstanding at the beginning and end of the annual accounting period;

(9) A list showing the name, address, and identifying number of, and the number of shares of each class of the corporation's stock held by, each United States person who is shareholder owning at any time during the annual accounting period 5 percent or more in value of any class of the corporation's outstanding stock;

(10) For the annual accounting period, the amount of the corporation's:

(i) Current earnings and profits;

(ii) Foreign income, war profits, and excess profits taxes paid or accrued,

(iii) Distributions out of current earnings and profits for the period; and

(iv) Distributions other than those described in paragraph (f)(10)(iii) of this section and the source thereof; and

(11) A summary showing the total amount of each of the following types of transactions of the corporation, which took place during the annual accounting period, with the person required to file this return, any other corporation controlled by that person, or any United States person owning at the time of the transaction 10 percent or more in value of any class of stock outstanding of the foreign corporation, or of any corporation controlling that foreign corporation:

(i) Sales and purchases of stock in trade;

(ii) Purchases of tangible property other than stock in trade;

(iii) Sales and purchases of patents, inventions, models, or designs (whether or not patented), copyrights, trademarks, secret formulas or processes, or any other similar property rights;

(iv) Compensation paid and compensation received for the rendition of technical, managerial, engineering, construction, scientific, or like services;

(v) Commissions paid and commissions received;

(vi) Rents and royalties paid and rents and royalties received;

(vii) Amount loaned and amounts borrowed (except open accounts resulting from sales and purchases reported under other items listed in this paragraph (f)(11) that arise and are collected in full in the ordinary course of business);

(viii) Dividends paid and dividends received;

(ix) Interest paid and interest received; and

(x) Premiums received for insurance or reinsurance.

For purposes of paragraph (f)(11) of this section, if the United States person is a bank, as defined in section 581, or is controlled within the meaning of section 368(c) by a bank, the term "transactions" shall not, as to a corporation with respect to which a return is filed, include banking transactions entered into on behalf of customers; in any event, however, deposits in accounts between a foreign corporation, controlled (within the meaning of paragraph (b) of this section) by a United States person, and a person described in paragraph (f)(11) of this section and withdrawals from such accounts shall be summarized by reporting end-of-month balances.

(g) *Financial statements.* The following information with respect to the foreign corporation shall be attached to and filed as part of the return required by this section:

(1) A statement of the corporation's profit and loss for the annual accounting period;

(2) A balance sheet as of the end of the annual accounting period of the corporation showing—

(i) The corporation's asset;

(ii) The corporation's liabilities; and

(iii) The corporation's net worth; and

(3) An analysis of changes in the corporation's surplus accounts during the annual accounting period including both opening and closing balances.

The information listed in this paragraph (g) shall be prepared in conformity with generally accepted accounting principles, and in such form and detail as is customary for the corporation's accounting records.

(h) *Method of reporting.* All amounts furnished under paragraphs (f) and (g) of this section shall be expressed in United States currency with a statement of the exchange rates used. All statements submitted on or with the return required under this section shall be rendered in the English language.

(i) *Time and place for filing return.* Returns on Form 2952 or Form 5471 required under paragraph (a) of this section shall be filed with the United States person's income tax return on or before the date required by law for the filing of that person's income tax return. District directors and directors of service centers are authorized to grant reasonable extensions of time for filing returns on Form 2952 or Form 5471 in accordance with the applicable provisions of §1.6081-1 of this chapter. An application for an extension of time for filing a return of income shall also be considered as an application for an extension of time for filing returns on Form 2952 or Form 5471.

(j) *Two or more persons required to submit the same information*—(1) *Return jointly made.* If two or more persons are required to furnish information with respect to the same foreign corporation for the same period, such persons may, in lieu of making separate returns, jointly make one return. Such joint return shall be filed with the income tax return of any one of the persons making such join return.

(2) *Persons excepted from furnishing information*—(i) *Conditions.* Any person required to furnish information under this section with respect to a foreign corporation need not furnish that information provided all of the following conditions are met:

(A) Such person does not directly own an interest in the foreign corporation;

(B) Such person is required to furnish the information solely by reason of attribution of stock ownership from a United States person under paragraph (c) of this section; and

(C) The person from whom the stock ownership is attributed furnishes all of the information required under this section of the person to whom the stock ownership is attributed.

(ii) *Illustrations.* The rule of this paragraph (j)(2) is illustrated by the following examples:

Example (1). A, a U.S. person owns 100 percent of the stock of M, a domestic corporation. A

also owns 100 percent of the stock of N, a foreign corporation organized under the laws of foreign country Y. A, in filing the information return required by this section with respect to N Corporation, in fact furnishes all the information required of M Corporation with respect to N Corporation. M Corporation need not file the information.

Example (2). X, a domestic corporation owns 100 percent of the stock of Y, a domestic corporation, Y Corporation owns 100 percent of the stock of Z, a foreign corporation. X Corporation is not excused by this paragraph (j)(2) from filing information with respect to Z Corporation because X Corporation is deemed to control Z Corporation under the provisions of paragraph (b) of this section without recourse to the attribution rules in paragraph (c) of this section.

(3) *Statement required.* Any United States person required to furnish information under this section with his return who does not do so by reason of the provisions of paragraph (j)(1) or (j)(2) of this section shall file a statement with his income tax return indicating that such liability has been (or, in the case of a join return made under paragraph (j)(1) of this section, will be) satisfied and identifying the return with which the information was or will be filed and the place of filing.

(k) *Failure to furnish information*—(1) *Dollar amount penalty*—(i) *In general.* If any person required to file Form 2952 or Form 5471 under section 6038 and this section fails to furnish any information described in paragraphs (f) and (g) of this section within the time prescribed by paragraph (i) of this section, such person shall pay a penalty of $1,000 for each annual accounting period of each foreign corporation with respect to which such failure occurs.

(ii) *Increase in penalty for continued failure after notification.* If a failure described in paragraph (k)(1)(i) of this section continues for more than 90 days after the date on which the district director mails notice of such failure to the person required to file Form 2952 or Form 5471, such person shall pay a penalty of $1,000, in addition to the penalty imposed by section 6038(b)(1) and paragraph (k)(1)(i) of this section, for each 30-day period (or fraction thereof) during which such failure continues after such 90-day period has expired. The additional penalty imposed by section 6038(b)(2) and this paragraph (k)(1)(ii) shall be limited to a maximum of $24,000 for each failure.

(iii) *Effective date.* The penalty imposed by section 6038(b) and this paragraph (k)(1) shall apply with respect to information for annual accounting periods ending after September 3, 1982.

(2) *Penalty of reducing foreign tax credit*—(i) *Effect on foreign tax credit.* Failure of a United States person to furnish, in accordance with the provisions of this section, any return or any information in any return, required to be filed for a taxable year under authority of section 6038 on or before the date prescribed in paragraph (i) of this section may affect the application of section 901 as provided in paragraph (k)(2)(ii) of this section and may affect the application of sections 902 and 960 as provided in paragraph (k)(2)(iii) of this section. Such failure may affect the application of sections 902 and 960 to any such United States person which is a corporation or to any person who acquires from any other person any portion (but only to the extent of such portion) of the interest of such other person in any such foreign corporation.

(ii) *Application of section 901.* In the application of section 901 to a United States person referred to in paragraph (k)(2)(i) of this section, the amount of taxes paid or deemed paid by such person for any taxable year, with or within which the annual accounting period of a foreign corporation for which such person failed to furnish information required under this section ended, may be reduced by 10 percent. However, no tax reduced under paragraph (k)(2)(iii) of this section or deemed paid under section 904(c) shall be reduced under the provisions of this paragraph (k)(2)(ii).

(iii) *Application of sections 902 and 960.* In the application of sections 902 and 960 to a United States person referred to in paragraph (k)(2)(i) of this section for any taxable year, the amount of taxes paid or deemed paid by each foreign corporation for the accounting period or periods for which such person was required for the taxable year of the failure to furnish information under this section may be reduced by 10 percent. The 10-percent reduction is not limited to the taxes paid or deemed paid by the foreign corporation with respect to which there is a failure to file information but may apply to the taxes paid or deemed paid by all foreign corporations controlled by that person. In applying subsections (a) and (b) of section 902, and in applying subsection (a) of section 960, the reduction provided by this paragraph (k)(2) shall not apply for purposes of determining the amount of accumulated profits in excess of income, war profits, and excess profits taxes.

(iv) *Reduction for continued failure after notice.* (A) If the failure referred to in paragraph (k)(2)(i) of this section continues for more than 90 days after the date on which the district director mails notice of such failure to such United States person, then the amount of the reduction referred to in paragraph (k)(2)(ii) and (iii) of this section may be 10 percent plus an additional 5 percent for each 3-month period, or fraction thereof, during which such failure continues after the expiration of such 90-day period.

(B) No taxes shall be reduced under this paragraph (k)(2) more than once for the same failure. Taxes paid by a foreign corporation when once reduced for a failure shall not be reduced again for the same failure in their status as taxes deemed paid by a corporate shareholder. Where a failure continues, each additional periodic 5-percent reduction, referred to in paragraph (k)(2)(iv)(A) of this section, shall be considered as part of the one reduction.

(v) *Limitation on reduction of foreign tax credit.* The amount of the reduction under this paragraph (k)(2) for each failure to furnish information with respect to a foreign corporation as required under this section shall not exceed the greater of:

(A) $10,000, or

(B) The income of the foreign corporation for its annual accounting period with respect to which the failure occurs.

For purposes of this section if a person is required to furnish information with respect to more than one foreign corporation, controlled (within the meaning of paragraph (b) of this section) by that person, each failure to submit information for each such corporation constitutes a separate failure.

(vi) *Offset for dollar amount penalty imposed.* The total amount of the reduction or reductions which, but for

this paragraph (k)(2)(vi), may be made under this paragraph (k)(2) with respect to any separate failure, shall not exceed the maximum amount of such reductions which may be imposed, reduced (but not below zero) by the amount of the dollar amount penalty imposed by paragraph (k)(1) of this section with respect to such separate failure.

(3) *Reasonable cause*—(i) For purposes of section 6038(b) and (c) and this section, the time prescribed for furnishing information under paragraph (i) of this section, and the beginning of the 90-day period after mailing of notice by the district director under paragraph (k)(1)(ii) and (k)(2)(iv)(A) of this section, shall be treated as being not earlier than the last day on which reasonable cause existed for failure to furnish the information.

(ii) To show that reasonable cause existed for failure to furnish information as required by section 6038 and this section, the person required to report such information must make an affirmative showing of all facts alleged as reasonable cause for such failure in a written statement containing a declaration that it is made under the penalties of perjury. The statement must be filed with the district director for the district or the director of the service center where the return is required to be filed. The district director or the director of the service center shall determine whether the failure to furnish information was due to reasonable cause, and if so, the period of time for which such reasonable cause existed. In the case of a return that has been filed as required by this section except for an omission of, or error with respect to, some of the information required, if the person who filed the return establishes to the satisfaction of the district director or the director of the service center that the person has substantially complied with this section, then the omission or error shall not constitute a failure under this section.

(4) *Other penalties.* The information required by section 6038 and this section must be furnished even though there are no foreign taxes which would be reduced under the provisions of this section, and even though the information required may not affect the amount of any tax due under the Internal Revenue Code. For criminal penalties for failure to file a return and filing a false or fraudulent return, see sections 7203, 7206, and 7207 of the Code.

(5) *Illustrations.* The provisions of this paragraph may be illustrated by the following examples.

Example (1). M, a domestic corporation owns 100 percent of the stock of N, a foreign corporation. Both M and N use the calendar year as a taxable year and annual accounting period, and all of the following events occur in or with respect to the 1980 taxable year. The dividend from N is the only dividend from a foreign corporation received by M during the taxable year, and the foreign taxes listed are the only foreign taxes paid or deemed paid by M and N for the taxable year. On March 15, 1981, M filed its income tax return and paid its income tax, but M did not file Form 2952 with respect to N's 1980 annual accounting period. On June 1, 1961, the district director mailed notice to M of M's failure to file Form 2952 with respect to N. On November 30, 1981, M filed a complete Form 2952 with respect to N's 1980 annual accounting period.

(a)	Gains, profits, and income of N	$100,000
(b)	Foreign tax paid by N with respect to such gains, profits, and income	40,000
(c)	Reduction of foreign tax paid by N (for purposes of M's section 902 deemed paid credit) resulting from M's failure to file information with respect to N as required under section 6038(a) and this section: failure to file within the time prescribed in paragraph (i) of this section, 10-percent reduction; continued failure for one additional 3-month period after 90-day period after notice mailed, 5-percent reduction; total reduction, 15 percent ($40,000 times 15 percent)	6,000
(d)	Foreign tax paid by N after section 6038(c)(1)(B) reduction	34,000
(e)	Dividend paid by N to M	45,000
(f)	Accumulated profits of N as defined in section 902(c)(1) (determined without regard to the section 6038(c)(1)(B) reduction)	100,000
(g)	Accumulated profits of N as described in section 902(a) (determined without regard to the section 6038(c)(1)(B) reduction)	60,000
(h)	For purposes of the section 902 credit, M is deemed to have paid the same proportion of foreign taxes paid (reduced as provided under section 6038(c)) with respect to the accumulated profits described in section 902(a) (determined without regard to the reduction provided under section 6038(c)) as the amount of the dividend (determined without regard to section 78) bears to such amount of accumulated profits	25,500

(45,000 ÷ 60,000) × 34,000 = 25,500

Must include $25,500 in gross income as a dividend under the provisions of section 78 of the Code. This example illustrates that the reductions in foreign taxes paid by the foreign corporation provided under section 8038(c) are taken into account in determining the amount included in gross income of the domestic corporation under section 78 of the Code as foreign taxes deemed paid, but such reductions are not taken into account in computing accumulated profits for purposes of determining the portion of foreign taxes deemed paid with respect to a particular dividend. The dollar amount penalty imposed by section 8038(b) and paragraph (k)(1) of this section does not apply with respect to information for annual accounting periods ending before September 4, 1982, and therefore does not apply to M with respect to M's failure to file Form 2952 in this example.

Example (2). The facts are the same as in example (1) except that all of the events occur in or with respect to the 1982 taxable year. On March 15, 1983. M filed its income tax return and paid its income tax, but M did not file Form 2952 or Form 5471 with respect to N's 1982 annual accounting period. On June 1, 1983, the district director mailed notice to M of M's failure to file Form 2952 or Form 5471 with respect to N. On November 30, 1983, M filed a complete Form 5471 with respect to N's 1982 annual accounting period. Under paragraph (k)(1)(i) of this section, M is subject to a penalty of $1,000. Under paragraph (k)(1)(ii) of this section, that penalty is increased by $4,000 because the failure continued for 92 days (three full 30-day periods and a fraction of a fourth 30-day period) after the end of the 90-day period following mailing of the notice by the district director, bringing M's dollar amount penalty under paragraph (k)(1) of this section to $5,000. For purpose of determining the foreign tax credit available to M, there may be imposed a reduction of foreign tax paid by N of $6,000, which would be the total of reductions under paragraph (k)(2) of this section with respect to M's failure to file under section 6038 for N's 1982 annual accounting period, before application of paragraph (k)(2)(vi) of this section. Under said paragraph (k)(2)(vi), the amount of the foreign tax reduction imposed is reduced by the amount of the dollar amount penalty, leaving a foreign tax reduction penalty of $1,000 which may be imposed in addition to the $5,000 dollar amount penalty. If imposed, the $1,000 tax reduction would then be applied in the calculation of taxes deemed paid by M under section 902 as in example (1), item (c), (d), and (h).

Par. 3. There is added after §1.6038-2 the following new section.

§1.6038A-1 Information returns required of certain foreign-owned corporations.

(a) *Requirement of return*—(1) *In general.* Every corporation which at any time during its taxable year is a re-

porting corporation (described in paragraph (b)(1) of this section) shall make a separate annual information return on Form 5472 with respect to each related corporation (described in paragraph (b)(4) of this section) with which such reporting corporation has had any transaction of the types listed in paragraph (c)(2) of this section during such taxable year.

(2) *Consolidated returns.* If a reporting corporation is a member of an affiliated group of corporations filing a consolidated income tax return, it may join in filing information returns on Form 5472 on a consolidated basis. A consolidated Form 5472 shall be filed by the common parent corporation and shall be accompanied by a copy of the group's Form 851 (Affiliations Schedule), indicating which members listed thereon are reporting on the Form 5472. A member is not required to join in filing a consolidated Form 5472 merely because other members of the group choose to file one or more Forms 5472 on a consolidated basis.

(3) *Exception.* Notwithstanding paragraph (a)(1) of this section, a reporting corporation is not required to make a return of information on Form 5472 with respect to a related corporation for a taxable year for which a U.S. person that controls the reporting corporation makes a return of information on Form 5471 that is required under section 6038 and §1.6038-2, if that return contains information required under §1.6038-2(f)(11) with respect to the transactions between the reporting corporation and the related corporation for that taxable year.

(b) *Definitions*—(1) *Reporting corporation*—(i) *In general.* For purposes of section 6038A and this section, a corporation is a reporting corporation if—

(A) It is a domestic corporation or is a foreign corporation engaged in a trade or business within the United States, and

(B) It is a controlled (as defined in paragraph (b)(2) of this section) by a foreign person.

(ii) *Exceptions.* Notwithstanding paragraph (b)(1)(i) of this section, a corporation is not a reporting corporation if—

(A) It has had no transactions of the types listed in paragraph (c)(2) during the taxable year with any related corporation,

(B) It has no gross income (determined without reference to losses) for the taxable year subject to United States taxation, other than a withholding tax under section 881 of the Code, or

(C) Its sole trade or business in the United States is a banking, financing, or similar business, as defined in §1.864-4(c)(5)(i).

(iii) *Consolidated returns.* For purposes of paragraph (c)(1)(iv) of this section only, in the case of a group of reporting corporations filing a consolidated information return under this section the term "reporting corporation" means the common parent corporation (as shown on Form 851).

(2) *Control* (i) *Generally.* A corporation shall be deemed to be controlled by a foreign person if at any time during that corporation's taxable year such foreign person owns stock possessing at least 50 percent of the total combined voting power of all classes of outstanding stock of the corporation entitled to vote, or stock possessing at least 50 percent of the total value of outstanding shares of all classes of stock of the corporation. A corporation that is controlled (by this same test) by another corporation, which in turn, is controlled by a foreign person, is also treated as being controlled by such foreign person. The provisions of this paragraph (b)(2)(i) are illustrated by the following example:

Example F, a foreign person, owns 50 percent of the voting stock of X, a domestic corporation. X owns 50 percent of the total value of shares of all classes of stock of Y, also a domestic corporation. Y is controlled by F for purposes of section 6038A and this section. Thus, control is attributed directly, under section 6038A(c)(1) and this section, rather than proportionately (as is stock ownership under section 318(a)(2) and paragraph (b)(2)(ii) of this section).

(ii) *Attribution rules.* For the purpose of determining ownership of stock of domestic or foreign corporations under section 6038A and this section, the constructive ownership rules of section 318(a) shall apply, except that section 318(a)(2)(C) shall be applied by substituting the phrase "10 percent" for the phrase "50 percent".

(3) *Foreign person.* For purposes of section 6038A and this section, a foreign person is—

(i) Any individual who is not a citizen or resident of the United States, but not including any individual for whom an election under section 6013(g) or (h) is in effect;

(ii) Any individual who is a citizen of any possession of the United States but is not otherwise a citizen of the United States and is not a resident of the United States;

(iii) Any partnership, association, company, or corporation which is not created or organized in the United States or under the law of the United States or any State thereof;

(iv) Any foreign trust or foreign estate, as defined in section 7701(a)(31); or

(v) Any foreign government (or agency or instrumentality thereof).

(4) *Related corporation.* For purposes of section 6038A and this section, a related corporation is any corporation which is a member of the same controlled group (as defined in paragraph (b)(5) of this section) as the reporting corporation. The term "member" shall include any component member, excluded member, or additional member (as defined in section 1563(b)) of the controlled group. However, the term "related corporation" does not include any corporation filing a consolidated income tax return with the reporting corporation.

(5) *Controlled group.* For purposes of section 6038A and this section, the term "controlled group" has the meaning given to such term by §1563(a), except that—

(i) Section 1563(a)(1) shall be applied by substituting the term "at least 50 percent" for the them "at least 80 percent" each time it appears;

(ii) Section 1563(a)(2)(B) shall be applied by substituting the term "at least 50 percent" for the term "more than 50 percent" each time it appears; and

(iii) Section 1563(a)(4), (b)(2)(C), and (e)(3)(C) shall not apply.

(c) *Contents of return*—(1) *The related corporation.* The return on Form 5472 shall contain such information as the form shall prescribe, with respect to each related corporation (whether foreign or domestic) with which the reporting corporation has had a transaction of the types listed in paragraph (c)(2) of this section during its taxable year, relating to:

(i) The name and addresses of the corporation;

(ii) The nature of the corporation's business or businesses and the principal place or places where conducted;

(iii) Each country in which the corporation treats itself as resident for purposes of the tax laws of that country; and

(iv) The relationship of the reporting corporation to the related corporation (such as reporting corporation controls related corporation, reporting corporation is controlled by related corporation, or reporting and related corporations are under common control).

(2) *Transactions with related foreign corporations*—(i) *Transactions for which monetary consideration was paid or received.* If the related corporation is a foreign corporation, the return on Form 5472 shall contain, with respect to transactions (other than transactions excepted by paragraph (c)(2)(iii) of this section) of the reporting corporation with the related corporation, in such form or manner as the form shall prescribe, a summary showing a reasonable estimate of the total dollar amount of each of the following types of transactions for which monetary considerations (U.S. currency and/or foreign currency) was the sole consideration paid or received, during the taxable year of the reporting corporation:

(A) Sales and purchases of stock in trade;

(B) Sales and purchases of tangible property other than stock in trade;

(C) Rents and royalties paid and received (other than amounts reported under paragraph (c)(2)(i)(D) of this section);

(D) Sales, purchases, and amounts paid and received as consideration for the use of intangible property such as copyrights, designs, formulas, inventions, models, patents, processes, trademarks, and other similar property rights;

(E) Consideration paid and received for the rendition of technical, managerial, engineering, construction, scientific, or like services;

(F) Commissions paid and received;

(G) Amounts loaned and borrowed (except open accounts resulting from sales and purchases reported under other items listed in this paragraph (c)(2)(i) that arise and are collected in full in the ordinary course of business);

(H) Interest paid and received;

(I) Premiums paid and received for insurance and reinsurance.

Amounts required to be reported under paragraph (c)(2)(i)(G) of this section shall be reported as monthly averages or outstanding balances at the beginning and end of the taxable year, as the form shall prescribe.

(ii) *Transactions involving nonmonetary consideration or no consideration.* If the related corporation is a foreign corporation, the return on Form 5472 shall contain a description of any transaction, or group of transactions, listed in paragraph (c)(2)(i) of this section (other than transactions excepted by paragraph (c)(2)(iii) of this section), of the reporting corporation with the related corporation, for which any consideration paid or received was other than monetary consideration described in paragraph (c)(2)(i) of this section, or for which no consideration was paid or received. A description required under this paragraph (c)(2)(ii) shall include sufficient information from which to determine the substance and approximate size of the transaction or group of transactions, and should include—

(A) A description of all property (including monetary consideration), rights, or obligations transferred from the reporting corporation to the related corporation and from the related corporation to the reporting corporation,

(B) A description of all services performed by the reporting corporation for the related corporation and by the related corporation for the reporting corporation, and

(C) A reasonable estimate of the fair market value or a statement of the nature and importance of such property (other than money), rights, obligations, or services.

A transaction for which the entire consideration paid or received by one party was monetary consideration is not required to be described under this paragraph (c)(2)(ii) even though the transaction involved the transfer of both tangible and intangible property, as long as the transfer of the intangible property was related and incidental to the transfer of the tangible property (e.g., a right to warranty services).

(iii) *Exception.* This paragraph (c)(2) shall not apply to any transaction if neither party to the transaction is a United States person (as defined in section 7701(a)(30)) and the transaction—

(A) Does not give rise to any recognized income or gain which is from sources within the United States or which is effectively connected with the conduct of a trade or business within the United States, and

(B) Does not give rise to any expense, loss, or other deduction properly allocable or apportionable to such income.

(iv) *Reasonable estimate defined*—(A) *Estimate within 25 percent of actual amount.* Any amount reported under this section is considered a reasonable estimate if such amount is at least 75 percent and not more than 125 percent of the actual amount to which the amount reported relates.

(B) *Other estimates.* If any amount reported under this section fails to meet the reasonable estimate test of paragraph (c)(2)(iv)(A) of this section, the reporting corporation may, nevertheless, show that such amount is a reasonable estimate by making an affirmative showing of relevant facts and circumstances in a written statement containing a declaration that it is made under the penalties of perjury. The statement must be filed with the district director or the director of the service center where the reporting corporation's income tax return and the return on Form 5472 were filed. The district director or the director of the service center shall determine whether the amount reported was a reasonable estimate.

(v) *Small amounts.* If any actual amount required to be reported under this section does not exceed $66,667, the amount may be reported as "$50,000 or less."

(V) *Accrued payments and receipts.* For purposes of this section, in the case of an accrual basis taxpayer, the terms "paid" and "received" shall include accrued payments and receipts, respectively.

(d) *Method of reporting.* All statements required on or with the return on Form 5472 under this section shall be rendered in the English language. All amounts of consideration or value required to be reported under this section shall be expressed in terms of United States currency, with a statement of any exchange rates used.

(e) *Time and place for filing returns*—(1) *In general.* Returns on Form 5472 required under this section shall generally be filed with the reporting corporation's income tax return for the same taxable year, and the due date (including extensions) for filing that income tax return is the due date for filing Form 5472. However, if a reporting corporation's income tax return is not timely filed (including extensions), the return on Form 5472 shall be filed with the Internal Revenue Service Center with which the reporting corporation's income tax return is required to be filed, and shall be filed on or before the date required by law (including extensions of time) for the filing of such income tax return.

(2) *Taxable years ending before* July 24, 1985. Returns on Form 5472 required under this section for any taxable year ending before July 24, 1985 shall be filed either with the reporting corporation's income tax return or with the Internal Revenue Service Center or the district director with which the reporting corporation's income tax return has been filed. Returns on Form 5472 for such taxable years shall be filed on or before November 21, 1985, or, if later, with the reporting corporation's income tax return for the same taxable year on or before the date required by law (including extensions of time) for the filing of such income tax return.

(3) *Duplicate filing required.* The reporting corporation shall file a duplicate copy of each Form 5472 (at the same time as the original copy is filed) with the Internal Revenue Service Center, Philadelphia, PA 19255.

(f) *Penalty for failure to furnish information*—(1) *In general.* If a corporation required to file Form 5472 under section 6038A and this section fails to furnish any information required under paragraph (c) of this section with respect to any related corporation, within the time prescribed by paragraph (e) of this section, such corporation shall pay a penalty of $1,000 for each taxable year with respect to which such information is not timely reported. This penalty shall only be imposed on a reporting corporation once for each related corporation for each taxable year for which a failure to furnish information occurs. For purposes of this paragraph (f)(1), each member of a group of corporations filing a consolidated information return is a separate reporting corporation.

(2) *Increase in penalty for continued failure after notification.* If a failure described in paragraph (f)(1) of this section continues for more than 90 days after the date on which the district director mails notice of such failure to the reporting corporation, that corporation shall pay a penalty of $1,000, in addition to the penalty imposed by section 6038A(d)(1) and paragraph (f)(1) of this section, for each 30-day period (or fraction thereof) during which such failure continues after such 90-day period has expired. The additional penalty imposed by section 6038A(d)(2) and this paragraph (f)(2) shall be limited to a maximum of $24,000 for such continuing failure.

(3) *Reasonable cause*—(i) For purposes of section 6038A(d) and this section, the time prescribed for furnishing information under paragraph (e) of this section, and the beginning of the 90-day period after mailing of notice by the district director under paragraph (f)(2) of this section, shall be treated as being not earlier than the last day on which reasonable cause existed for failure to furnish the information.

(ii) To show that reasonable cause existed for failure to furnish information as required by section 6038A and this section, the reporting corporation must make an affirmative showing of all facts alleged as reasonable cause for such failure in a written statement containing a declaration that is is made under the penalties of perjury. The statement must be filed with the district director for the district or the director of the service center where the return is required to be filed. The district director or the director of the service center shall determine whether the failure to furnish information was due to reasonable cause, and if so, the period of time for which such reasonable cause existed.

In the case of a return that has been filed as required by this section except for an omission of, or error with respect to, some of the information required, if the person who filed the return establishes to the satisfaction of the district director or the director of the service center that the person has substantially complied with this section, then the omission or error shall not constitute a failure under this section.

(4) *Other penalties.* The information required by section 6038A and this section must be furnished even though it may not affect the amount of any tax due under the Internal Revenue Code. For criminal penalties for failure to file a return and filing a false or fraudulent return, see sections 7203, 7206, and 7207 of the Code.

(g) *Effective date.* This regulation is effective for taxable years beginning after December 31, 1983.

Par. 4. The authority for Part 602 is as follows:

Authority: 26 U.S.C. 7805.

Par. 5. Section 602.101 (c) is amended by inserting in the appropriate place in the table §1.6038-2 ... 1545-0805" and "1.6038A-1 ... 1545-0805".

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved July 2, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 23, 1985, 8:45 a.m., and published in the issue of the Federal Register for July 24, 1985, 50 F.R. 30160).

Section 6038A.—Information With Respect to Certain Foreign-Owned Corporations

26 CFR 1.6038A-1: Information returns required of certain foreign-owned corporations.

Returns required of certain foreign-owned corporations with respect to transactions with related corporations. See T.D. 8040, page 291.

Subpart B.—Information Concerning Transactions with Other Persons

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Section 6041.—Information at Source

26 CFR 1.6041-1: Return of information as to payments of $600 or more.

Whether exchanges of services between individual taxpayers in the course of their trades or businesses are subject to the information reporting requirements of sections 6041 and 6041A. See Rev. Rul. 85-101, page 301.

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26 CFR 7.6041-1: Return of information as to payments of winnings from bingo, keno, and slot machines.
(Also Section 7701; 301.7701-1.)

Returns; information; Indian tribes. Indian tribal governments that operate bingo establishments are subject to the information reporting requirements of section 6041 of the Code.

Rev. Rul. 85-194

ISSUE

Are Indian tribal governments that operate bingo establishments subject to the information reporting requirements of section 6041 of the Internal Revenue Code?

FACTS

An American Indian tribe operates a bingo establishment as a tribally owned business. The bingo facility is owned by the tribe and is located on land held in trust by the United States for the Indian tribe. A general council composed of all persons qualified to vote in tribal elections is the governing body of the tribe. The bingo facility is operated by, and under the authority of, the general council. The proceeds derived from the bingo activity are used for the support of programs to promote the health, education, and welfare of the tribe. In the course of the bingo operations payments equal to or exceeding $1,200 are made from time to time by the tribe.

LAW AND ANALYSIS

Under section 6041(a) of the Code all persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of $600 or more in any taxable year shall render a true and accurate return to the Secretary, under such regulations and in such form and manner and to such extent as may be prescribed by the Secretary, setting forth the amount paid and the name and address of the recipient of each such payment.

Under section 7.6041-1 of the Temporary Income Tax Regulations, every person engaged in a trade or business and making a payment in the course of such trade or business of winnings of $1,200 or more from a bingo game must make an information return with respect to such payment. In determining whether such winnings equal or exceed the $1,200 amount, the amount of winnings shall not be reduced by the amount wagered, winnings shall include the fair market value of a payment in any medium other than cash, all winnings by the winner from one bingo game shall be aggregated, and winnings and losses from any other wagering transaction by the winner shall not be taken into account. The return shall be made on Form W-2G and shall be filed with the Internal Revenue Service Center serving the district in which is located the principal place of business of the person making the return. The return shall be filed on or before February 28 of the calendar year following the calendar year in which the payment of winnings is made.

Section 7701(a)(1) of the Code provides that, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, the term "person" shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation.

The purpose of section 6041 of the Code is to help the federal government locate recipients of income and ascertain amounts they receive. *United States v. Haimowitz*, 404 F.2d 38 (2d Cir. 1968) (per curiam). *See* S. Rep. No. 103, 65th Cong., 1st Sess. 20 (1917), 1939-1 (Part 2) C.B. 56, 67.

Indian tribes have been recognized as distinct political communities. They have been characterized as unique aggregations possessing attributes of sovereignty over their members and their territory. Although physically within the territory of the United States and subject to ultimate federal control, they nonetheless remain a separate people with the power of regulating their internal and social relations. *See United States v. Wheeler*, 435 U.S. 313 (1978).

In the instant case, the Indian tribe is in the trade or business of operating a bingo facility and, in the course of that trade or business, makes payments of winnings of $1,200 from time to time. The application of section 6041 of the Code to the Indian tribe furthers the purpose of section 6041 to locate recipients of income. Moreover, the term "person," as defined in section 7701(a)(1), is sufficiently broad to include a governmental body. *See Ohio v. Helvering*, 292 U.S. 360 (1934), XIII-1 C.B. 531 (1934). In this regard, section 1.6041-1(g) of the Income Tax Regulations, which requires officers and employees of the United States, or of a state, to file information returns under section 6041 in the case of payments made by the United States, or by a state, otherwise coming within section 6041.

HOLDING

Indian tribes that operate bingo establishments for profit are subject to the information reporting requirements of section 6041 of the Code.

Section 6041A.—Returns Regarding Payments of Remuneration for Services and Direct Sales.

(Also Section 6041; 1.6041-1.)

Returns; information; exchange of services. Payments in the form of services rendered in the course of a trade or business are subject to the reporting requirements of section 6041(a) and 6041A of the Code.

Rev. Rul. 85-101

ISSUE

Are exchanges of services between individual taxpayers in the course of their trades or businesses as described below subject to the information reporting requirements of section 6041 and 6041A of the Internal Revenue Code?

FACTS

Situation 1. An attorney and a professional painter agreed to an exchange of services whereby the attorney will represent the painter in an action involving non-payment of business debts in return for the painting of the attorney's law offices. The value of the services performed by each is $600. Neither the painter nor the attorney is incorporated. The agreement is not effected through a broker, as that term is defined in section 6045 of the Code.

Situation 2. The same as *Situation 1* except that the attorney represents the painter in a divorce proceeding.

LAW AND ANALYSIS

Section 6041(a) of the Code provides

that all persons engaged in a trade or business and making payments in the course of such trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of $600 or more in any taxable year must render a true and accurate return setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment. Reporting under section 6041(a) is not required with regard to payments for which reporting is required under certain other sections of the Code, such as section 6045 (relating to reporting by brokers).

Section 6041A(a) of the Code provides that if any service-recipient engaged in a trade or business pays in the course of such trade or business during any calendar year remuneration to any person for services performed by such person and the aggregate of the remuneration paid to the person during the calendar year is $600 or more, then the service-recipient must make a return setting forth the amount of the payments and the name and address of the recipient of the payments.

Section 6041A was added to the Code by section 312(a) of Pub. L. No. 97-248, 1982-2 C.B. 462, 561. The conference report states that until new regulations are issued under section 6041A, the existing regulatory exceptions under section 6041 will continue to apply. H.R. Rep. No. 97-760 (Conf. Rep.), 97th Cong., 2d Sess. 467 (1982), 1982-2 C.B. 600, 646.

Section 1.6041-1(a)(2) of the regulations provides generally that Forms 1096 and 1099 shall be used for making information returns.

Section 1.6041-1(b) of the regulations states that section 6041(a) of the Code applies only to payments in the course of a trade or business; hence it does not apply, for example, to an amount paid by the proprietor of a trade or business to a physician for medical services rendered by the physician to the proprietor's child.

In *Situation 1* the attorney's remuneration to the painter in the form of services is for a trade or business expense, the repainting of the attorney's law offices. Likewise, the painter's remuneration to the attorney in the form of services is for a trade or business expense, representation by the attorney in an action for the non-payment of business debts. In *Situation 2*, however, while the services performed by the attorney are performed in the course of the attorney's trade or business, they are not related to the painter's trade or business but are services in connection with the painter's divorce proceeding, a personal matter. Hence, the payment by the painter to the attorney is not being made in the course of the painter's trade or business, even though the payment is in the form of services of the type normally performed in the course of the painter's trade or business.

HOLDING

Situation 1. The payments in the form of services rendered by both the attorney and the painter are subject to the information reporting requirements of sections 6041(a) and 6041A(a) of the Code. Forms 1096 and 1099 must be used for making the required information return. The amount reportable is the fair market value of the services rendered.

Situation 2. The payment by the attorney is subject to the information reporting requirements of sections 6041(a) and 6041A(a) of the Code. Forms 1096 and 1099 must be used for making the required information return. The amount reportable is the fair market value of the services rendered. The payment by the painter is not subject to information reporting.

Section 6045.—Returns of Brokers

26 CFR 1.6045-1: Returns of information of brokers and barter exchanges.

Returns; information; brokers; short-term state government bonds. A broker must file an information return on the retirement of short-term state government bonds, even though interest on the obligations is exempt from tax.

Rev. Rul. 85-102

ISSUE

Under section 6045(a) of the Internal Revenue Code, must a broker file an information return on the retirement of short-term state government bonds in the situation described below?

FACTS

X, a broker as defined in section 1.6045-1(a) of the Income Tax Regulations, is the paying agent for certain short-term obligations of State *M* issued in bearer form. The obligations were issued without any original issue discount on August 1, 1983. *X* retired the 12-month obligations on maturity. Interest on the obligations was exempt from tax under section 103 of the Code.

LAW AND ANALYSIS

Section 6045(a) of the Code provides that every person doing business as a broker must, when required by the Secretary, make a return, in accordance with prescribed regulations, showing the name and address of each customer, and other information as the Secretary may by forms or regulations prescribe.

Section 1.6045-1(a) of the Income Tax Regulations defines a "broker" as a person that, in the ordinary course of a trade or business during the calendar year, stands ready to effect sales to be made by others. Section 1.6045-1(a)(9) defines the term "sale" to include retirement of indebtedness.

Section 1.6045-1(c)(2) of the regulations provides that a broker must make an information return with respect to such sale by a customer of the broker effected by the broker in the ordinary course of a trade or business in which the broker stands ready to effect sales to be made by others, unless the sales come under one of the listed exceptions. Under section 1.6045-1(c)(3)(v)(c), no information return is required upon retirement of obligations having a fixed maturity date not exceeding one year from the date of issuance ("short-term obligations") that have original issue discount, as defined in section 1273(a) of the Code.

The regulations under section 6045 contain no exceptions to the reporting requirements of short-term obligations unless they have original issue discount. Because the obligations in question had no original issue discount, these obligations do not fall within the exception set forth in section 1.6045-1(c)(3)(v)(c) of the regulations.

HOLDING

The broker must file an information

return with respect to the retirement of the obligations on Form 1099-B, Statement for Recipients of Proceeds from Broker and Barter Exchange Transactions, even though interest on the obligations is exempt from tax.

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26 CFR 1.6045-2: Furnishing statement required with respect to certain substitute payment.

T.D. 8029

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Furnishing Statements Requred With Respect to Certain Substitute Payments

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to statements required to be furnished by brokers and information returns of brokers. Changes to the applicable law were made by the Tax Reform Act of 1984 [Pub. L. 98–369, 1984–3 C.B. (Vol. 1) 1]. The regulations provide that a broker must furnish statements to its customers with respect to certain substitute payments received by the broker on behalf of such customers. The regulations also provide that brokers must make returns of information to the Internal Revenue Service respecting any customer to which such broker is required to furnish a statement. These regulations, which supersede the temporary regulations on this subject, affect brokers that receive substitute payments on behalf of customers and provide such brokers with the guidance needed to comply with the law.

DATES: The regulations apply to substitute payments received by brokers after December 31, 1984. The cross-references added to Part 1 under sections 6042 and 6049 are effective after December 31, 1984.

FOR FURTHER INFORMATION CONTACT: Bruce H. Jurist of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T), 202-566-3238, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On October 24, 1984, the FEDERAL REGISTER published temporary regulations (T.D. 7987; 49 FR 42715) [1984-2 C.B. 248] and proposed amendments (49 FR 42744) [LR-133-84, 1984-2 C.B. 907] to the Income Tax Regulations (26 CFR Part 1) under section 6045 of the Internal Revenue Code of 1954. These amendments were proposed to conform the regulations to section 146 of the Tax Reform Act of 1984 (Pub. L. 98–369, 98 Stat. 690) [1984–3 C.B. (Vol. 1) 1]. Three written comments responding to this notice were received. No requests for a public hearing were received and accordingly none was held. After consideration of all written comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

PUBLIC COMMENTS

Section 6045(d) requires brokers to furnish written statements to their customers showing the amount of payments in lieu of dividends or tax-exempt interest (or such other items as the Secretary may prescribe) received by brokers on behalf of their customers. The proposed regulations required a broker to furnish a statement informing an individual that a payment is a substitute payment in lieu of a capital gain distribution or a return of capital, provided that the broker had reason to know the character of the payment by January 31 of the calendar year following the year in which the payment was received. Two comments were received suggesting that this requirement be removed from the regulations because, at the time substitute payments are made, brokers are unable to determine that the payments are in lieu of a capital gain distribution or are in lieu of a return of capital. In response to those comments, the final regulations provide that a broker is required to furnish a statement informing an individual that a payment is a substitute payment in lieu of a capital gain distribution or a return of capital, only if the broker has reason to know the character of the payment on the record date of such payment.

The proposed regulations required a broker to determine the identity of the customer whose securities were transferred and on whose behalf the broker received substitute payments. The determination with respect to substitute payments (other than for tax-exempt dividends and tax exempt interest) had to be made using one of the following methods: (1) specific identification; (2) allocation and selection; or (3) any other method with the prior approval of the Commissioner. Under the allocation and selection method, the broker proportionately allocates the transferred shares of stock between two pools of shares, one consisting of shares owned by individuals and one consisting of shares owned by nonindividuals.

The Internal Revenue Service has received a number of applications for approval of identification methods that purportedly fall under the third method (*i.e.*, a method requiring the prior approval of the Commissioner). The identification methods described in the majority of these applications relate to various forms of the allocation and selection method described in §1.6045-2(f)(2)(ii). Prior approval by the Commissioner is not required for any type of random or first-in-first-out ("FIFO") allocation method within the pool of nonindividual shares These applications indicate that the scope of the third method has been misunderstood. The Commissioner's approval is necessary only where identification of customers is based on a nonrandom method other than FIFO identification.

A commentator requested that the allocation and selection method be amended to allow brokers to allocate transferred shares first to shares of the same class and issue borrowed from other brokers or customers and then to the two pools. The final regulations adopt the requested change.

Section 1.6045–2(b)(1) of the proposed regulations provided that a broker need not furnish a statement to a customer on whose behalf the broker receives substitute payments that aggregate less than $10 in a calendar year. A commentator requested that this minimal payments exception be expanded to an annual $10 per issue per customer exception. This request was not adopted in the final regulations.

Section 1.6045-2(a)(4)(ii) of the proposed regulations defined the term "broker," in part, as any person described in §1.6045–1(a)(1). A commentator requested that the proposed regulations be amended to incorporate specifically the exceptions to the definition of broker provided in example (2) of §1.6045-1(b). Such an express incorporation is unnecessary. Because example (2) of §1.6045-1(b) includes a cross-reference to §1.6045-1(a) and the proposed regulations defined broker with reference to §1.6045-1(a), example (2) was included in the definition of broker in the proposed regulations by a series of cross-references. Therefore, no specific incorporation of example (2) is made in the final regulations.

Two commentators requested that the effective date of the requirement to furnish statements be delayed. Section 150(b) of the Tax Reform Act of 1984 provides that section 6045(d) applies to payments received after December 31, 1984. The Tax Reform Act of 1984 does not authorize the Internal Revenue Service to administratively change the statutorily prescribed effective date, and a delay in the effective date of the statement requirement is not adopted in the final regulations. Penalties for failure to file information returns or to furnish written statements, however, may be waived if it can be shown that such failure was due to reasonable cause and not to willful neglect.

SPECIAL ANALYSES

Although a notice of proposed rulemaking soliciting public comments was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these regulations are not subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

The Treasury Department has determined that these final regulations are not major rules under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983. Accordingly, a Regulatory Impact Analysis is not required.

PAPERWORK REDUCTION ACT

The collection of information requirements contained in these regulations have been submitted to the Office of Management and Budget ("OMB") in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these regulations is Bruce H. Jurist of the Legislation and Regulations Division on the Office of Chief Counsel, Internal Revenue Service. However, other personnel in the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations.

Accordingly, 26 CFR Part 1 and Part 602 are amended as follows:

Paragraph 1. New §1.6045–2 is added at the appropriate place. The new section is set forth below.

§1.6045-2 Furnishing statement required with respect to certain substitute payments.

(a) *Requirement of furnishing statement*— (1) *In general.* Any broker (as defined in paragraph (a)(4)(iii) of this section) that transfers securities (as defined in §1.6045-1(a)(3)) of a customer (as defined in paragraph (a)(4)(iii) of this section) for use in a short sale and receives on behalf of the customer a substitute payment (as defined in paragraph (a)(4)(i)) shall, except as otherwise provided, furnish a statement to the customer identifying such payment as being a substitute payment.

(2) *Special rule for transfer for broker's own use.* Any broker that borrows securities of a customer for use in a short sale entered into for the broker's own account shall be deemed to have transferred the stock to itself and received on behalf of the customer any substitute payment made with respect to the transferred securities, and shall be required to furnish a statement with respect to such payments in accordance with paragraph (a)(1) of this section.

(3) *Special rule for furnishing statements to individual customers with respect to payments in lieu of dividends*—(i) *In general.* Except as otherwise provided, a broker that receives a substitute payment in lieu of a dividend on behalf of a customer who is an individual ("individual customer") need not furnish a statement to the customer.

(ii) *Exception for certain dividends.* Any broker that receives on behalf of an individual customer a substitute payment in lieu of—

(A) An exempt-interest dividend (as defined in paragraph (a)(4)(vii) of this section);

(B) A capital gain dividend (as defined in paragraph (a)(4)(vi) of this section);

(C) A distribution treated as a return of capital under section 301(c)(2) or (c)(3); or

(D) An FTC dividend (as defined in paragraph (a)(4)(viii) of this section)

shall furnish a statement to the individual customer identifying the payment as being a substitute payment as prescribed by this section, provided that the broker has reason to know not later than the record date of the dividend payment that the payment is a substitute payment in lieu of an exempt-interest dividend, a capital gain dividend, a distribution treated as a return of capital, or an FTC dividend.

(4) *Meaning of terms.* The following definitions apply for purposes of this section.

(i) The term "substitute payment" means a payment in lieu of—

(A) Tax-exempt interest, to the extent that interest has accrued on the obligation for the period during which the short sale is open;

(B) A dividend, the ex-dividend date for which occurs during the period after the transfer of stock for use in a short sale, and prior to the closing of the short sale; or

(C) Any other item specified in a rule-related notice published in the Federal Register (provided that such items shall be subject to the rules of this section only subsequent to the time of such publication).

For purposes of this section original issue discount accruing on an obligation (the interest upon which is exempt from tax under section 103) for the period

during which the short sale is open shall be deemed a payment in lieu of tax-exempt interest.

(ii) The term "broker" means both a person described in §1.6045-1(a)(1) and a person that, in the ordinary course of a trade or business during the calendar year, loans securities owned by others.

(iii) The term "customer" means, with respect to a transfer of securities for use in a short sale, the person that is the record owner of trhe securities so transferred.

(iv) The term "dividend" means a dividend (as defined in section 316) or a distribution that is treated as a return of capital under section 301 (c)(2) or (c)(3).

(v) The term "tax-exempt interest" means interest to which the exception in section 6049(b)(2)(B) applies,

(vi) The term "capital gain dividend" means a capital gain dividend as defined in section 852(b)(3)(C) or section 857(b)(3)(C).

(vii) The term "exempt-interest dividend" means an exempt-interest dividend as defined in section 852(b)(5)(A).

(viii) The term "FTC dividend" means a dividend with respect to which the recipient is entitled to claim a foreign tax credit under section 901 (but not by virtue of taxes deemed paid under section 902 or 960).

(5) *Examples.* The following examples illustrate the definition of a substitute payment in lieu of tax-exempt interest found in paragraph (a)(4)(i)(A) of this section.

Example (1). On September 1, 1984, L, a broker, borrows 200 State Q Bonds (the interest upon which is exempt from tax under section 103) held in street name for customer R and transfers the bonds to W for use in a short sale. The bonds each have a face value of $100 and bear 12% stated annual interest paid semiannually on January 1 and July 1 of each year. The bonds were not issued with original issue discount. On November 1, 1984, W closes the short sale and returns State Q Bonds to L. On January 1, 1985, L receives a $1200 interest payment (6% × $100 × 200 bonds = $1200) from State Q with respect to R's bonds. Four hundred dollars (2 months the bonds were on loan/6 months in the interest period = ⅓ × $1200 = $400) of the interest payment represents accrued interest on the obligations for the period during which the short sale was open and is a substitute payment in lieu of tax-exempt interest within the meaning of paragraph (a)(4)(i)(A) of this section. L must furnish a statement under paragraph (a) of this section to R for calendar year 1985 with respect to the $400 substitute payment.

Example (2). Assume the same facts as in Example (1), except that W closes the short sale on February 1, 1985. On January 1, 1985, L receives a $1200 payment from W with respect to R's bonds. Eight hundred dollars (4 months the bonds were on loan prior to January 1, 1985/6 months in the interest period = ⅔ × $1200 = $800) of the payment represents accrued interest on the obligation for the period during which the short sale was open and is a substitute payment in lieu of tax-exempt interest. On July 1, 1985, L receives a $1200 payment from State Q. Two hundred dollars (1 month the bonds were on loan after December 31, 1984/6 months in the interest period = 1/6 × $1200 = $200) of the payment represents accrued interest on the obligation for the period during which the short sale was open and is a substitute payment in lieu of the tax-exempt interest. Because both payments are received by L in 1985, L must furnish a statement under paragraph (a) of this section to R for that year with respect to both payments.

(b) *Exceptions*—(1) *Minimal payments.* No statement is required to be furnished under section 6045(d) or this section to any customer if the aggregate amount of the substitute payments received by a broker on behalf of the customer during a calendar year for which a statement must be furnished is less than $10.

(2) *Exempt recipients*—(i) *In general.* A statement shall not be required to be furnished with respect to substitute payments made to a broker on behalf of—

(A) An organization exempt from taxation under section 501(a),

(B) An individual retirement plan,

(C) The United States, a possession of the United States, or an instrumentality or a political subdivision or a wholly-owned agency of the foregoing,

(D) A State, the District of Columbia, or a political subdivision or a wholly-owned agency or instrumentality of either of the foregoing,

(E) A foreign government or a political subdivision thereof, or

(F) An international organization.

(ii) *Determination of whether a person is described in paragraph (b)(2)(i) of this section.* The determination of whether a person is described in paragraph (b)(2)(i) of this section shall be made in the manner provided in §5f.6045-1(c)(3)(i)(B) of the Temporary Income Tax Regulations under the Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462].

(3) *Exempt foreign persons.* A statement shall not be required to be furnished with respect to substitute payments made to a broker on behalf of a person that is an exempt foreign person as described in §1.6045-1(g).

(c) *Form of statement.* A broker shall furnish the statement required by paragraph (a) of this section on Form 1099. The statement must show the aggregate dollar amount of all substitute payments received by the broker on behalf of a customer (for which the broker is required to furnish a statement) during a calendar year, and such other information as may be required by Form 1099. A statement shall be considered to be furnished to a customer if it is mailed to the customer at the last address of the customer known to the broker.

(d) *Time for furnishing statements.* A broker must furnish the statements required by paragraph (a) of this section for each calendar year. Such statements shall be furnished after April 30th of such calendar year but in no case before the final substitute payment for the calendar year is made, and on or before January 31 of the following calendar year.

(e) *When substitute payment deemed received.* A broker is deemed to have received a substitute payment on behalf of a customer when the amount is paid or deemed paid to the broker (or as it accrues in the case of original issue discount deemed a payment in lieu of tax-exempt interest).

(f) *Identification of customer and record-keeping with respect to substitute payments*—(1) *Payments in lieu of tax-exempt interest and exempt-interest dividends.* A broker that receives substitute payments in lieu of tax-exempt interest, exempt-interest dividends, or other items (to the extent specified in a rule-related notice published pursuant to paragraph (a)(4)(i)(C) of this section) on behalf of a customer and is required to furnish a statement under paragraph (a) of this section must determine the identity of the customer whose security was transferred and on whose behalf the broker received such substitute payments by specific identification of the record owner of the security so transferred. A broker must keep adequate records of the determination so

made.

(2) *Payments in lieu of dividends other than exempt-interest dividends*—(i) *Requirements and methods.* A broker that receives substitute payments in lieu of dividends, other than exempt-interest dividends, on behalf of a customer and is required to furnish a statement under paragraph (a) of this section must make a determination of the identity of the customer whose stock was transferred and on whose behalf such broker receives substitute payments. Such determination must be made as of the record date with respect to the dividend distribution, and must be made in a consistent manner by the broker in accordance with any of the following methods:

(A) Specific identification of the record owner of the transferred stock;

(B) The method of allocation and selection specified in paragraph (f)(2)(ii) of this section; or

(c) Any other method, with the prior approval of the Commissioner.

A broker must keep adequate records of the determination so made.

(ii) *Method of allocation and selection— (A) Allocation to borrowed shares and individual and nonindividual pools.* With respect to each substitute payment in lieu of a dividend received by a broker, the broker must allocate the transferred shares (*i.e.*, the shares giving rise to the substitute payment) among all shares of stock of the same class and issue as the transferred shares which were (1) borrowed by the broker, and (2) which the broker holds (or has transferred in a transaction described in paragraph (a)(1) of this section) and is authorized by its customers to transfer (including shares of stock of the same class and issue held for the broker's own account) ("loanable shares"). The broker may first allocate the transferred shares to any borrowed shares. Then to the extent that the number of transferred shares exceeds the number of borrowed shares (or if the broker does not allocate to the borrowed shares first), the broker must allocate the transferred shares between two pools, one consisting of the loanable shares of all individual customers (the "individual pool") and the other consisting of the loanable shares of all nonindividual customers (the "nonindividual pool"). The transferred shares must be allocated to the individual pool in the same proportion that the number of loanable shares held by individual customers bears to the total number of loanable shares available to the broker. Similarly, the transferred shares must be allocated to the nonindividual pool in the same proportion that the number of loanable shares held by nonindividual customers bears to the total number of loanable shares available to the broker.

(B) *Selection of deemed transferred shares within the nonindividual pool.* The broker must select which shares within the nonindividual pool are deemed transferred for use in a short sale (the "deemed transferred shares"). Selection of deemed transferred shares may be made either by purely random lottery or on a first-in-first-out ("FIFO") basis.

(C) *Selection of deemed transferred shares within the individual pool.* The broker must select which shares within the individual pool are deemed transferred shares (in the manner described in the preceding paragraph) only with respect to substitute payments as to which a statement is required to be furnished under paragraph (a)(2)(ii) of this section.

(3) *Examples.* The following examples illustrate the identification of customer rules of paragraph (f)(2):

Example (1). A, a broker, holds X corporation common stock (of which there is only a single class) in street name for five customers: C, a corporation; D, a partnership; E, a corporation; F, an individual; and G, a corporation. C owns 100 shares of X stock, D owns 50 shares of X stock, E owns 100 shares of X stock, F owns 50 shares of X stock, and G owns 100 shares of X stock. A is authorized to loan all of the X stock of C, D, E, and F. G, however, has not authorized A to loan its X stock. A does not hold any X stock in its trading account nor has A borrowed any X stock from another broker. A transfers 150 shares of X stock to H for use in a short sale on July 1, 1985. A dividend of $2 per share is declared with respect to X stock on August 1, 1985, payable to the owners of record as of August 15, 1985 (the "record" date). A receives $2 per transferred share as a payment in lieu of a dividend with respect to X stock or a total of $300 on September 15, 1985. H closes the short sale and returns X stock to A on January 2, 1986. A's record specificially identify the owner of each loanable share of stock held in street name. From A's records it is determined that the shares transferred to H consisted of 100 shares owned by C, 25 shares owned by D, and 25 shares owned by F. The substitute payment in lieu of dividends with respect to X stock is therefore attributed to C, D and F based on the actual number of their shares that were transferred to H. Accordingly, C receives $200 (100 shares X $2 per share), and D and F each receive $50 (25 shares each X $2 per share). A must furnish statements identifying the payments as being in lieu of dividends to both C and D, unless they are exempt recipients as defined in paragraph (b)(2) of this section or exempt foreign persons as defined in paragraph (b)(3) of this section. Assuming that A had no reason to know on the record date of the payment that the dividend paid by X is of a type described in paragraph (a)(3) (ii)(A)-(D) of this section, A need not furnish F with a statement under section 6045(d) because F is an individual. (However, A may be required to furnish F with a statement in accordance with section 6042 and the regulations thereunder. See paragraph (h) of this section.) By recording the ownership of each share transferred to H, A has complied with the identification requirement of paragraph (f)(2) of this section.

Example (2). Assume the same facts as in example (1), except that A's records do not specifically identify the record owner of each share of stock. Rather, all shares of X stock held in street name are pooled together. When A receives the $2 per share payment in lieu of a dividend, A determines the identity of the customers to which the payment relates by the method of allocation and selection prescribed in paragraph (f)(2)(ii) of this section. First, the transferred shares are allocated proportionately between the individual pool and the nonindividual pool. One-sixth of the transferred shares or 25 shares are allocated to the individual pool (50 loanable shares owned by individuals/300 total loanable shares = 1/6; 1/6 × 150 transferred shares = 25 shares). Assuming A has no reason to know by the record date of the payment that the payment is in lieu of a dividend of a type described in paragraph (a)(3)(ii)(A)-(D) of this section, no selection of deemed transferred shares within the individual customer pool is required. (However, A may be required to furnish P with a statement under section 6042 and the regulations thereunder. See paragraph (h) of this section.) Five-sixths of the transferred shares or 125 shares are allocated to the nonindividual pool (250 loanable shares owned by nonindividuals/300 total loanable shares = 5/6; 5/6 × 150 transferred shares = 125 shares). A must select which 125 shares within the nonindividual pool are deemed to have been transferred. Using a purely random lottery, A selects 100 shares identified as being owned by C, and 25 shares identified as being owned by D. Accordingly, A is deemed to have transferred 100 shares and 25 shares owned by C and D respectively, and received substitute payments in lieu of dividends of $200 (100 shares × $2 per share) and $50 (25 shares × $2 per share) on behalf of C and D respectively. A must furnish statements to both C and D identifying such payments as being in lieu of dividends unless they are exempt recipients as defined in paragraph (b)(2) of this section or exempt foreign persons as defined in paragraph (b)(3) of this section. A has complied with the identification requirement of paragraph (f)(2) of this section.

(g) *Reporting by brokers*—(1) *Requirement of reporting.* Any broker required to furnish a statement under paragraph (a) of this section shall report on Form 1096 showing such information as may be required by Form 1096.

in the form, manner, and number of copies required by Form 1096. With respect to each customer for which a broker is required to furnish a statement, the broker shall make a return of information on Form 1099, in the form, manner and number of copies required by Form 1099.

(2) *Use of magnetic media.* Brokers not receiving an undue hardship exception under paragraph (l)(2) of §1.6045-1 shall file the returns required by this paragraph on magnetic media in accordance with paragraph (l)(1) of §1.6045-1.

(3) *Time and place of filing.* The returns required under this paragraph (g) for any calendar year shall be filed after September 30 of such year, but not before the final substitute payment for the year is received by the broker, and on or before February 28 of the following year with any of the Internal Revenue Service Centers, the addresses of which are listed in the instructions for Form 1096.

(h) *Coordination with section 6042.* In cases in which reporting is required by both sections 6042 and 6045(d) with respect to the same substitute payment in lieu of a dividend, the provisions of section 6045(d) control, and no report or statement under section 6042 need be made. If reporting is not required under section 6045(d) with respect to a substitute payment in lieu of a dividend, a report under section 6042 must be made if required in accordance with the rules of section 6042 and the regulations thereunder. Thus, if a broker receives a substitute payment in lieu of a dividend on behalf of an individual customer and the broker does not have reason to know by the record date of the payment that the payment is in lieu of a dividend of a type described in paragraph (a)(3)(ii)(A)-(D) of this section, the broker must report with respect to the substitute payment if required in accordance with section 6042 and the regulations thereunder.

(i) *Effective date.* These regulations apply to substitute payments received by a broker after December 31, 1984.

Par. 2. paragraph (a)(2) of section 1.6042-3 is amended by adding the following sentence to the end thereof.

§1.6042-3 Dividends subject to reporting.

(a) * * *

(2) * * * See §1.6045-2(h) for coordination of the reporting requirements under sections 6042 and 6045(d) with respect to payments in lieu of dividends.

* * * * *

Par. 3. Paragraph (a)(5) of section 1.6049-5 is amended by adding the following sentence to the end thereof.

§ 1.6049-5 Interest and original issue discount subject to reporting after December 31, 1982.

(a) * * *

(5) * * * See §1.6045-2 for reporting requirements with respect to payments in lieu of tax-exempt interest.

* * * * *

Par. 4. Section 602.101(c) is amended by inserting in the appropriate place in the table "§1.6045–2(a)(1) . . . 1545-0115" and "§1.6045-2(f) . . . 1545-0115" and "§1.6045-2(g)(1) . . . 1545-0115."

This Treasury decision is issued under the authority contained in sections 6045 and 7805 of the Internal Revenue Code of 1954 (98 Stat. 699, 26 U.S.C. 6045, 68A Stat. 917, 25 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved May 20, 1985

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 4, 1985, 8:45 a.m., and published in the issue of the Federal Register for June 5, 1985, 50 F.R. 23676)

Section 6049.—Returns Regarding Payments of Interest

26 CFR 1.6049-4: Returns of information as to interest paid and original issue discount includible in gross income after December 31, 1982. (Also Section 3406; 35a.9999-3.)

Information returns; citizens of U.S. possessions. The Bureau of Public Debt, its nominees, or agents are required to make information returns under section 6049 of the Code with respect to U.S. source interest paid on U.S. Treasury obligations to citizens of U.S. possessions. The payors may also be required to deduct and withhold, under section 3406 of the Code, a tax equal to 20 percent of such payments.

Rev. Rul. 85-200

Interest on U.S. Government obligations paid to citizens of United States possessions is subject to information reporting and backup withholding. An information return is required under section 1.6049-4 of the Income Tax Regulations with respect to United States source interest (including original issue discount includible in gross income) that is paid to citizens of Guam, Puerto Rico, or the Northern Marianas; to citizens of American Samoa who are United States citizens by naturalization in a state, territory, or the District of Columbia; and to citizens of the Virgin Islands of the United States who provide notification under Rev. Proc. 81-20, 1981-1 C.B. 690, that they expect to satisfy their U.S. income tax obligations by paying their taxes to the Virgin Islands. United States source interest includes interest paid on, and original issue discount on, United States Treasury obligations. Section 1.6049-4 of the regulations provides whether, in any given circumstance, the information reporting is to be done by the Bureau of Public Debt itself or by its nominees or middlemen within the United States (federal reserve banks and commercial banks) or by its paying agents in United States possessions.

An information return is not required for interest paid to citizens of American Samoa who are not U.S. citizens by naturalization in a state, territory, or the District of Columbia or for interest paid to citizens of the U.S. Virgin Islands who do not provide notice under Rev. Proc. 81-20. Pursuant to section 6049(b)(2)(C)(ii) of the Internal Revenue Code, information reporting is not required in these instances, because the interest paid to such citizens is subject to income tax withholding under section 1441 of the Code.

Under section 3406 of the Code, as added by section 104(a) of the Interest and Dividend Tax Compliance Act of 1983, 1983-2 C.B. 352, 353, if the interest payment (or original issue discount) is required to be reported under section 6049 of the Code, then in certain circumstances the Bureau of Public Debt or its nominees or paying agents

may also be required to deduct and withhold from such payment a tax equal to 20 percent of such payment.

Section 6050E.—State and Local Income Tax Refunds

26 CFR 1.6050E-1: Reporting of State and local income tax refunds

T.D. 8052

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER A, SUBCHAPTER H, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 5f—TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982; PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Reporting of State and Local Income Tax Refunds

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the reporting of State and local income tax refunds. Changes to the applicable law were made by the Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462] and the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. The regulations affect all persons who, with respect to individuals, make payments of refunds of State and local income taxes, or allow credits or offsets with respect to such taxes, and provide them with the guidance to comply with the law.

DATES: The regulations are effective for refunds made, and credits and offsets allowed, after December 31, 1982.

FOR FURTHER INFORMATION CONTACT: Alice M. Bennett of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3238 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On September 15, 1983, the Federal Register published temporary regulations (48 FR 41385) [T.D. 7913, 1983-2 C.B. 222] and proposed amendments (48 FR 41436) [LR-233-82, 1983-2 C.B. 769] to the Income Tax Regulations (26 CFR Part 1) under section 6050E of the Internal Revenue Code of 1954. These amendments were proposed to provide rules relating to the information reporting of State and local income tax refunds, credits, and offsets under section 6050E of the Code. Section 6050E was added to the Code by section 313 of the Tax Equity and Fiscal Responsibility Act of 1982 (96 Stat. 603) [Pub. L. 97-248, 1982-2 C.B. 462, 562]. Section 6050E subsequently was amended by section 151 of the Tax Reform Act of 1984 (98 Stat. 690) [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1, 198].

Five written comments were received with respect to the proposed amendments to the regulations. A public hearing was not held. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision. The Treasury decision also reflects the changes made to section 6050E by the Tax Reform Act of 1984.

TAX REFORM ACT OF 1984

Section 6050E as originally enacted did not provide any exception to the reporting requirement or the requirement to furnish statements to taxpayers with respect to a refund, credit or offset made or allowed to a taxpayer who did not claim itemized deductions for Federal income tax purposes for the taxable year giving rise to the refund, credit, or offset. The temporary and proposed regulations, however, provide that a refund officer need not make an information return or send a statement to the applicable taxpayer if the refund officer can verify that the taxpayer did not claim itemized deductions for Federal income tax purposes for the taxable year giving rise to the refund, credit, or offset.

The Tax Reform Act of 1984 amended section 6050E to provide an exception only to the requirement to furnish statements to taxpayers if it can be determined, in the manner provided by regulations, that the applicable taxpayer did not claim itemized deductions for Federal income tax purposes for the taxable year giving rise to the refund, credit, or offset. The amendment is effective for refunds, credits, and offsets made or allowed after December 31, 1982. Congress intended that a refund officer be required to make an information return with respect to itemizers and non-itemizers who receive a refund, credit, or offset of State or local income taxes. Therefore, the Treasury decision provides that a refund officer need not send a statement to a taxpayer with respect to a refund, credit, or offset of personal income taxes if the refund officer can verify, in the manner provided by the regulations, that the taxpayer did not claim itemized deductions for Federal income tax purposes for the taxable year giving rise to the refund, credit, or offset. The refund officer, however, must make an information return with the Internal Revenue Service with respect to those refunds, credits, and offsets.

PUBLIC COMMENTS

The temporary and proposed regulations provide that a refund officer can verify that a taxpayer did not claim itemized deductions for Federal income tax purposes for the taxable year giving rise to the refund, credit or offset only from the three sources listed in the regulations. The first listed source of verification is a copy of Schedule A of the individual's Federal income tax return if the copy is required to be attached to the State or local income tax return. The second listed source is the State or local income tax return if transcription of information from schedule A of the Federal return on the State or local income tax return is required for the purpose of computing liability for the State or local income tax. The third listed source is information obtained through a voluntary information exchange agreement with the United States for the applicable taxable year.

One comment suggested that the list of sources for verification of non-itemization be expanded to include information transcribed on the State or local income tax return from the Federal return (other than schedule A), where the information can be used by the refund officer to determine independently whether the taxpayer itemized deductions for Federal income tax

purposes. The Service believes, however, that for verification purposes the transcription of such information on the State or local income tax return must be required by the State or local taxing authority for the purpose of computing the taxpayer's liability for the State or local income tax. The Service believes that this additional requirement is necessary in order to ensure that the transcribed information will be subject to the same checks for accuracy as other information on the State or local income tax return. Consequently, the Treasury decision provides that, in addition to the sources of verification set forth in the temporary and proposed regulations, information transcribed from the Federal return (other than Schedule A) on the State or local income tax return may be used to verify non-itemization if two conditions are met. First, the transcription of the information must be required for the purpose of computing liability for the State or local income tax. Second, the information must be such that the refund officer can determine conclusively from that information whether the taxpayer itemized deductions for Federal income tax purposes.

The Treasury decision also clarifies that the State or local income tax return is the source of verification in cases where a copy Schedule A of the Federal return is required to be attached to the State or local income tax return, or where transcription of information from Schedule A of the Federal return is required for the purpose of computing liability for the State or local income tax. In this connection, the Treasury decision provides that the omission of a copy of the Schedule A, or of information required to be transcribed from the Schedule A, must be consistent with the taxpayer's computation of tax on the State or local income tax return. In addition, the information contained on the Schedule A must be required for the purpose of computing liability for the State or local income tax.

The remaining comments suggested revisions to the regulations that either would have conflicted with the express statutory language of section 6050E, or would have placed an unreasonable burden on refund officers by requiring them to determine whether taxpayers who itemized deductions for Federal tax purposes received a tax benefit from the payment to which the State or local income tax refund, credit or offset is attributable. These suggestions were not adopted.

In particular, several comments suggested that the regulations be revised to allow a refund officer to furnish the required statement to the applicable taxpayers at any time before the end of January of the calendar year following the calendar year in which the refund is paid or the credit or offset is allowed. Section 6050E(b), however, provides that the statement must be furnished to the taxpayer during January of the calendar year following the calendar year in which the refund is paid or the credit or offset is allowed. This requirement was not changed by the Tax Reform Act of 1984. Therefore, in accordance with section 6050E(b), the Treasury decision retains the rule contained in the temporary and proposed regulations that the statement must be furnished to the taxpayer during January of the calendar year following the calendar year in which the refund is paid or the credit or offset is allowed.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this rule is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required. Although a notice of proposed rulemaking soliciting public comments was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these regulations are not subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

The collection of information requirements contained in this regulation have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these regulations is Alice M. Bennett of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 1, 5f, and 602 are amended as follows:

INCOME TAX REGULATIONS
(26 CFR Part 1)

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805, * * *

Section 1.6050E-1 also issued under 26 U.S.C. 6050E.

Par 2. The following new section shall be added at the appropriate place:

§1.6050E-1 Reporting of State and local income tax refunds.

(a) *Applicability.* Section 6050E and this section apply to any refund officer who, with respect to an individual, makes payments of refunds of State or local income taxes or allows credits or offsets with respect to such taxes aggregating $10 or more for such individual in any calendar year.

(b) *Definitions.* For purposes of this section—

(1) The term "refund officer" means the officer or employee of a State or local taxing jurisdiction having control of payments of refunds or the allowance of credits or offsets, or the person appropriately designated for purposes of this section.

(2) The term "State" shall include the District of Columbia but shall not include the Commonwealth of Puerto Rico or any possession of the United States.

(3) The term "individual" shall not include an estate or trust.

(4) The term "credit or offset" means an overpayment of tax which, in lieu of being refunded to the taxpayer, is:

(i) Applied against an existing liability of the taxpayer,

(ii) Available for application against a future liability of the taxpayer, or

(iii) Otherwise used or available for use for the taxpayer's benefit.

(c) *Requirement of reporting.* Every

refund officer described in paragraph (a) of this section shall make an information return in accordance with this section for each calendar year. An information return must be made even if the refund officer is not required to furnish a statement to the applicable taxpayer under paragraph (k)(2) of this section.

(d) *Prescribed Form.* Except as otherwise provided in paragraph (i) of this section, the information return required by paragraph (c) of this section shall be made on Forms 1096 and 1099.

(e) *Refunds involving different taxable years.* In the case of refunds paid or credits or offsets allowed during a calendar year with respect to two or more taxable years of an individual, a separate Form 1099 shall be filed with respect to each taxable year of the individual. Thus, if during calendar year 1983 a refund officer pays to an individual a refund of $15 with respect to that individual's taxable year ending in 1982 and $20 with respect to that individual's taxable year ending in 1981, a separate Form 1099 shall be filed for each of the two payments. If, instead, the refund with respect to the individual's taxable year ending in 1982 were $5 instead of $15, no return would be required for the payment of $5.

(f) *Information required.* The information required to be reported on Forms 1096 and 1099 includes the aggregate amount of refunds, credits, and offsets made or allowed during the calendar year with respect to the taxable year of the individual covered by the return; the name, address and taxpayer identification number of the individual with respect to whom such payment, credit, or offset was made or allowed; the taxable year covered by the return; and such other information as may be required by the forms. In addition, the nature of the tax is required to be indicated on the Form 1099 in any case where the refund, credit or offset is made or allowed with respect to a payment attributable to an income tax that applies exclusively to income from a trade or business and is not a tax of general application.

(g) *when credit or offset deemed allowed.* For purposes of a return of information under this section, a credit or offset is deemed to be allowed when the liability to pay or credit such amount is admitted by the State or local taxing jurisdiction. Thus, if an amount with respect to a taxpayer's 1982 taxable year is credited in 1983 to reduce the liability of the taxpayer to make estimated tax payments in 1983, it is reportable as a credit allowed in 1983. It is not reportable in the taxable year that gives rise to the refund, credit or offset.

(h) *Time and place for filing.* The returns required under this section for any calendar year shall be filed after September 30 of that calendar year, but not before the refund officer's final payment (or allowance of credit or offset) for the year, and on or before February 28 of the following year. Returns shall be filed with the appropriate Internal Revenue Service Center, the addresses of which are listed in the instructions for Forms 1099. For extensions of time for filing returns under this section, see §1.6081-1.

(i) *Use of magnetic media and substitute forms*—(1) *Magnetic media.* A refund officer may be required to file the Forms 1099 required by this section on magnetic media or machine-readable paper forms. See section 6011(e) and applicable regulations and revenue procedures thereunder. If a refund officer is not required to file the Forms 1099 required by this section on magnetic media, the refund officer may request permission under applicable regulations and revenue procedures to submit the information required by this section on magnetic media.

(2) *Substitute forms.* A refund officer may prepare and use a form which contains provisions identical with those of Form 1096 if the refund officer complies with all revenue procedures relating to substitute Form 1096 in effect at that time. In addition, if a refund officer is not required to file the Forms 1099 required by this section on magnetic media or machine-readable paper forms, the refund officer may prepare and use a form which contains provisions identical with those of Form 1099 if the refund officer complies with all revenue procedures relating to substitute Form 1099 in effect at that time.

(j) *Voluntary information exchange agreements.* The requirements of reporting information to the Internal Revenue Service under this section may be satisfied for any calendar year by submission of the information required under paragraph (f) of this section in accordance with the terms of a voluntary information exchange agreement between the State and the United States in effect during such year.

(k) *Requirement of furnishing statements to recipients*—(1) *In general.* Except as provided in paragraph (k)(2) of this section, every refund officer required to make a return of information under this section shall furnish to the individual whose identifying number is required to be shown on the return a written statement showing the aggregate amount shown on the information return of refunds, credits and offsets made or allowed to such individual with respect to each taxable year of the individual the name of the State or local taxing jurisdiction paying such refund or allowing such credits or offsets, the taxable year giving rise to the refund, credit or offset and a legend stating that such amount is being reported to the Internal Revenue Service. The requirement of this paragraph may be met by furnishing to the individual a copy of the Form 1099 filed with respect to that individual provided that the form bears a legend stating that such amount is being reported to the Internal Revenue Service. For purposes of this paragraph, a statement shall be considered to be furnished to an individual if it is mailed to the individual at the individual's last known address.

(2) *Exception for non-itemizers.* A refund officer need not furnish a statement to an individual under paragraph (k)(1) of this section if the refund officer verifies that the individual did not claim itemized deductions for Federal income tax purposes for the taxable year giving rise to the refund, credit, or offset. This exception shall not apply, however, if the refund, credit, or offset is made or allowed with respect to a payment attributable to an income tax that applies exclusively to income from a trade or business and is not a tax of general application. For purposes of this paragraph (k)(2), verification shall be made solely from—

(i) The State or local income tax return, or

(ii) Information obtained through a voluntary information exchange agreement with the United States for the applicable taxable year.

(3) *Verification from the State or local income tax return.* A refund officer shall verify from the State or local income tax return that an individual did not claim itemized deductions for Federal income tax purposes for the applicable taxable year only if—

(i)(A) An individual who itemized deductions for Federal income tax purposes either must attach a copy of Schedule A of the individual's Federal income tax return to the State or local income tax return or must transcribe information from Schedule A of the individual's Federal income tax return on the State or local income tax return;

(B) The information contained on or transcribed from the Schedule A is required for the purpose of computing liability for the State or local income tax; and

(C) The omission of a copy of the Schedule A, or of the information required to be transcribed from the Schedule A, is consistent with the taxpayer's computation of tax on the State or local income tax return; or

(ii) Individuals are required to transcribe information from their Federal income tax return (other than from Schedule A) on the State or local income tax return for the purpose of computing liability for the State or local income tax and the information can be used to determine conclusively whether the taxpayer itemized deductions for Federal income tax purposes.

(4) *Example.* The provisions of paragraph (k)(3)(ii) of this section may be illustrated by the following example:

Example. State X asks for transcription of the following information on its 1983 income tax return from the taxpayer's 1983 Federal income tax return: Adjusted gross income; taxable income; and number of exemptions claimed. The amount of adjusted gross income and the number of exemptions claimed on the Federal income tax return are taken into account in computing the liability for income tax under the laws of State X. The amount of taxable income transcribed from the Federal return, however, does not enter into the computation of liability for income tax under the laws of State X. Thus, this amount may not be taken into account by the refund officer of State X for purposes of verifying whether a taxpayer itemized deductions for Federal income tax purposes. Since the refund officer of State X will not be able to determine conclusively from the amount of adjusted gross income and the number of exemptions transcribed from the Federal return whether a taxpayer itemized deductions for Federal income tax purposes, the transcribed information does not meet the requirements of paragraph (k)(3)(ii) of this section.

(l) *Time for furnishing statements*—(1) *General rule.*

(2) *Time for furnishing statements.* The statement required under paragraph (k) of this section shall be furnished after December 31 of the year in which the refund is paid or credit or offset is allowed, and on or before January 31 of the following year.

(2) *Extensions of time.* For good cause shown upon written application of the refund officer, the service center director may grant an extension fo time not exceeding 30 days in which to furnish statements under this paragraph. The application shall be addressed to the Service Center with which the Forms 1099 required under this section are required to be filed and shall contain a concise statement of the reasons for requesting the extension to aid the service center director in determining the period of the extension, if any, which will be granted. The application shall state at the top of the first page that it is made under this section and shall be signed by the refund officer. In general, the application shall be filed after September 30 of the year in which the refund is paid or credit or offset is allowed, and before January 15 of the following year.

(m) *Effective date.* This section applies to payments of refunds, and credits and offsets allowed after December 31 1982.

TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982
(26 CFR Part 5f)

Par. 3. The authority for Part 5f is revised to read as set forth below and the authority citations following all sections in Part 5f are removed:

Authority: 26 U.S.C. 7805. Sections 5f.103-1 and 5f.163-1 also issued under 26 U.S.C. 103(j), 26 U.S.C. 163(f), and 96 stat. 595. Section 5f.6045-1 also issued under 26 U.S.C. 6045.

Par. 4. Part 5f of 26 CFR is amended by removing §5f.6050E-1.

OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT
(26 CFR Part 602)

Par. 5. The authority for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 6. Section 602.101(c) is amended by inserting in the appropriate place in the table "§1.6050E-1 . . . 1545-0120".

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved August 12, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 12, 1985, 8:45 a.m., and published in the issue of the Federal Register for September 13, 1985, 50 F.R. 37347)

Section 6050H.—Returns Relating to Mortgage Interest Received in Trade or Business from Individuals

Specifications for printing paper substitutes for Form 1098. See Rev. Proc. 85-52, page 718.

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26 CFR 1.6050H-1T: Questions and answers concerning information returns relating to mortgage interest received in a trade or business from individuals

T.D. 8047

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEAR BEGINNING AFTER DECEMBER 31, 1953; PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Returns Relating to Mortgage Interest Received in a Trade or Business From Indivduals

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to the requirement of reporting mortgage interest received in a trade or business from individuals. Changes to the applicable law were made by the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. The regulations affect any person who is engaged in a trade or business and who, in the course of such

trade or business, receives $600 or more of interest from any individual on any mortgage in a calendar year. The regulations provide these persons with the guidance necessary to comply with the law. In addition, the text of the temporary regulations set forth in this document serves as the text of the proposed regulations cross-referenced * * * [on page 832, this Bulletin].

DATES: The regulations apply with respect to mortgage interest received after December 31, 1984.

FOR FURTHER INFORMATION CONTACT: Annette J. Guarisco of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3238 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document amends the Income Tax Regulations (26 CFR Part 1) to provide rules relating to the reporting of mortgage interest received in a trade or business from individuals under section 6050H of the Internal Revenue Code of 1954. The regulations reflect the addition of section 6050H to the Code by section 145 of the Tax Reform Act of 1984 (Pub. L. 98-369, 98 Stat. 685) [1984-3 C.B. (Vol. 1) 1, 192]. The temporary regulations will remain in effect until superseded by final regulations on this subject.

This document also amends 26 CFR part 602 to provide for the display of the OMB control numbers under the Paperwork Reduction Act.

EXPLANATION OF PROVISIONS

Section 6050H provides that an information return must be made by any person who is engaged in a trade or business and who, in the course of the trade or business, receives from any individual $600 or more of interest on any mortgage in a calendar year. The term "mortgage" is defined separately for obligations in existence on December 31, 1984, and obligations incurred after December 31, 1984. Any person required to make an information return under section 6050H must also furnish a statement to the payor or, if applicable, payor of record on or before January 31 of the calendar year following the year in which the interest was received. The regulations under section 6050H provide that, in cases where there is more than one individual responsible for repayment of a mortgage, the mortgage interest recipient must report only with respect to the payor of record. A payor of record is defined in the regulations.

The regulations provide that amounts received from the Department of Housing and Urban Development on mortgages insured under section 235 of the National Housing Act (12 U.S.C. §§1701–1715z (1982 & Supp. 1983)) should not be reported under section 6050H as received from the borrower. In addition, amounts received after December 31, 1986, from any governmental unit (or any agency or instrumentality thereof) under a mortgage subsidy program should not be reported under section 6050H as received from the borrower.

The regulations also require that interest paid by a seller on a purchaser's mortgage should not be reported under section 6050H as received from the purchaser. This rule will permit the Internal Revenue Service to effectively monitor proper treatment of such payments. For example, the Service would be assured that, if interest paid by the seller is properly deductible by the purchaser, the stated purchase price of the property would be reduced to reflect (and hence its basis would not include) the amount of the interest paid by the seller and deducted by the purchaser.

The Service has considered the use of Form 1098 (the form used to report under section 6050H) to report not only interest paid by a borrower, but also related information about the amount (if any) of mortgage credit allowable to the borrower under section 25 of the Code. Section 25 permits a mortgage credit for certain borrowers in a state which has issued mortgage credit certificates. As issued in temporary form, these regulations do not require interest recipients to report the amount of the mortgage credit allowable under section 25. If the number of taxpayers claiming such credit or the level of noncompliance with the requirements of that section indicate that reporting to borrowers and the Service would be desirable, however, the Service may, by regulation, require reporting of this information for future years.

Due to the effective date of section 6050H, there is need for immediate guidance so that persons subject to the reporting requirement can make preparations to comply with these provisions. Therefore, these regulations have been drafted in question and answer format in order to facilitate their timely publication. No inference should be drawn, however, regarding issues not raised herein or from the inclusion of certain questions and not others in these regulations.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this temporary rule is not a major rule as defined in Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983.

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for temporary regulations. Accordingly, the Regulatory Flexibility Act does not apply and Regulatory Impact Analysis is not required for these regulations.

The collection of information requirements contained in these regulations have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB. Control number 1545-0901

DRAFTING INFORMATION

The principal author of these regulations is Annette J. Guarisco of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 1 and 602 are amended as follows:

INCOME TAX REGULATIONS

(26 CFR Part 1)

Paragraph 1. The authority for Part

is amended by adding the following citation:

Authority: 26 U.S.C. 7805 * * * section 1.6050H-1T also issued under 26 U.S.C. 6050H.

Par. 2. The following new section is added at the appropriate place.

§1.6050H-1T *Questions and answers concerning information returns relating to mortgage interest received in a trade or business from* individuals. (Temporary). The following questions and answers relate to the requirement of reporting mortgage interest under section 6050H of the Internal Revenue Code of 1954, as added by section 145 of the Tax Reform Act of 1984 (Pub. L. 98-369, 98 Stat. 685):

Requirement of Reporting

In general

Q-1: What does section 6050H provide with respect to the reporting of mortgage interest?

A-1: In general, section 6050H provides that an information return must be made by any person who is engaged in a trade or business and who, in the course of such trade or business, receives from any individual $600 or more of interest on any mortgage in a calendar year. For purposes of this section—

(a) Any person who is engaged in a trade or business and who, in the course of such trade or business, receives interest on any mortgage is referred to as an "interest recipient"; and

(b) Any individual who pays interest on any mortgage is referred to as a "payor".

Interest subject to reporting

Q-2: Does the reporting requirement apply to all interest received by an interest recipient?

A-2: No. The reporting requirement applies only to interest received from a payor on a mortgage (as defined in A-4 and A-5 of this section). The reporting requirement does not apply to interest received from a trust, estate, partnership, association, company, or corporation.

Q-3: Does the reporting requirement apply to any amount of mortgage interest received from a payor?

A-3: No. The reporting requirement applies only if $600 or more of interest is received from a payor on any mortgage in a calendar year. The 4600 threshold is determined on an obligation by obligation basis. Therefore, if the interest received from a payor on an obligation is less than $600, reporting with respect to that interest is not required even if the total interest received from the payor on all obligations held by the interest recipient exceeds $600 in a calendar year.

Q-4: What is a mortgage, for purposes of this section and section 6050H, with respect to obligations in existence on December 31, 1984?

A-4: An obligation in existence on December 31, 1984, that is secured primarily by real property (regardless of whether the property is located inside or outside the United States) is a mortgage unless, at the time the obligation was incurred, the interest recipient reasonably classified such obligation as other than a mortgage, real property loan, real estate loan, or other similar type of obligation. (See A-12 of this section for rules relating to interest received by foreign persons.) For example, if an obligation incurred in 1980 was secured primarily by real property, but the interest recipient reasonably classified the obligation as a commercial loan because the proceeds were used to finance the payor's trade or business, the obligation is not considered a mortgage for purposes of this section and section 6050H. If, however, a majority of the obligations in a particular class are primarily secured by real property, it is not reasonable to classify such obligations as other than mortgages, real property loans, real estate loans, or other similar types of obligations; such obligations are, therefore, mortgages for purposes of section 6050H and this section. For purposes of this definition, real property includes stock in a cooperative housing corporation. A mortgage does not include a credit card obligation that is secured primarily by real property or a line of credit that is secured primarily by real property.

Q-5: What is a mortgage, for purposes of this section and section 6050H, with respect to obligations incurred after December 31, 1984?

A-5: With respect to obligations incurred after December 31, 1984, a mortgage is any obligation that is secured primarily by real property, regardless of whether the property is located inside or outside the United States. (See A-12 of this section for rules relating to interest received by foreign persons.) For purposes of this definition, real property includes stock in a cooperative housing corporation. A mortgage does not include a credit card obligation that is secured primarily by real property or a line of credit that is secured primarily by real property. The determination of whether a particular obligation is a mortgage shall be made without regard to the interest recipient's classification of that obligation. For example, if an obligation is secured primarily by real property, but the interest recipient classifies the obligation as a commercial loan because the proceeds are to be used to finance the payor's trade or business, the obligation is nevertheless a mortgage for purposes of this section and section 6050H.

Q-6: If the amount of interest received on a mortgage in a calendar year is less than the amount of interest due on the mortgage, what amount of interest must be reported under this section?

A-6: The amount of interest received must be reported. For example, assume that $800 of interest is payable in a calendar year but only $600 of interest is received in the calendar year. The amount of interest received ($600) must be reported under this section. Similarly, assume that an interest recipient accrues $900 of interest on a mortgage in a calendar year but only $800 of interest is payable and is received in the calendar year (resulting in a $100 increase in the unpaid balance of the loan). The amount of interest received ($800) must be reported under this section.

Q-7: If a payor remits 13 payments of interest on any mortgage in a calendar year, but the interest recipient receives only 12 payments in the calendar year, what amount should the interest recipient report?

A-7: The interest recipient should report the interest actually received in the calendar year. For example, if a payor mails the 13th payment on December 31 of a calendar year, and the interest recipient does not receive it until the following calendar year, the interest recipient should report only the 12 payments received in the calendar year.

Trade or business requirement

Q-8: Must an interest recipient be

engaged in the trade or business of lending money to be subject to the reporting requirement of this section?

A-8: No. An interest recipient (other than a governmental unit, or any agency or instrumentality thereof) is subject to this reporting requirement if the interest recipient is engaged in any trade or business and, in the course of such trade or business, receives from an individual $600 or more of interest on any mortgage in a calendar year. For example, if A, a real estate developer, provides financing to B, an individual, to enable B to purchase a house in a subdivision owned and developed by A, and that house is the primary security for the financing, A is subject to this reporting requirement. Alternatively, if C, a physician, who is not engaged in any other trade or business, lends money to D to enable D to purchase C's home, C is not subject to the reporting requirement of this section because C will not receive the interest in the course of his sole trade or business of being a physician.

Q-9: How does that trade or business requirement apply to a governmental unit?

A-9: A governmental unit (or any agency or instrumentality thereof) which receives from a payor $600 or more of interest on any mortgage in a calendar year is subject to the reporting requirement without regard to the requirement that the money be received in the course of a trade or business. A governmental unit (or any agency or instrumentality thereof) that is subject to the reporting requirement must designate an officer or employee to make the return. The designated officer or employee must make the return in the form and manner prescribed by this section.

Treatment of cooperative housing corporations

Q-10: How does this reporting requirement apply in the case of cooperative housing corporations?

A-10: For purposes of section 6050H and this section, a cooperative housing corporation (as defined in section 216) is treated as a person who is engaged in a trade or business and who, in the course of such trade or business, receives interest from its tenant-stockholders on a mortgage. Therefore, a cooperative housing corporation is required to report under section 6050H and this section.

Interest received on behalf of another

Q-11: If, in the course of a trade or business, a person receives (collects) interest on behalf of another, who is required to report?

A-11: The person first receiving (collecting) the interest is required to report. For example, a servicing bank that receives $600 or more of mortgage interest in a calendar year from a payor on behalf of a lender is required to report the interest received under this section. No reporting is required under this section upon the transfer of the interest from the servicing bank to the lender for whom the interest was received.

Interest received by foreign persons

Q-12: Must an interest recipient that is a foreign person report under section 6050H and this section?

A-12: An interest recipient that is a foreign person must report with respect to mortgage interest that is received at a location within the United States. In the case of interest received at locations outside the United States, an interest recipient that is a foreign person must report—

(a) If the foreign person is a controlled foreign corporation within the meaning of section 957(a); or

(b) If the foreign person is a corporation any interest received from which would be considered to be from sources within the United States under section 861(a)(1)(C) (without regard to whether the interest is paid or credited by a domestic branch of a foreign corporation engaged in the commercial banking business).

Multiple borrowers

Q-13: When there is more than one borrower on a mortgage, must the interest recipient report with respect to each borrower?

A-13: No. The interest recipient must report only with respect to the payor of record (as defined in A-14 of this section) on the mortgage. The amount of interest subject to reporting is the full amount received by the interest recipient with respect to the mortgage during the calendar year.

Q-14: Who is a payor of record?

A-14: For purposes of this section, the payor of record is the individual carried on the books and records of the interest recipient as the principal bo
rower or the individual designated b
the interest recipient as the payor
record.

Interest paid by third parties

Q-15: If an interest recipient receiv
interest on a mortgage from a perso
other than the borrower, must the inte
est recipient report this amount as r
ceived from the borrower?

A-15: In general, yes. Except as ot
erwise provided in this A-15 and A-1
of this section, an interest recipie
must report all amounts received on
borrower's mortgage as received fro
the borrower under section 6050H a
this section. For example, assume th
N is the borrower on a mortgage a
that interest is received on the mortga
from N's mother. The interest that
received from N's mother on N's mo
gage is reportable under section 6050
and this section as received from
However, interest that is paid by
seller on a purchaser's mortgage sha
not be reported under section 6050
and this section as received from t
purchaser. For example, if a real esta
developer deposits an amount in escro
with the interest recipient and advis
the interest recipient to draw on the a
count to pay interest on a purchase
mortgage, this interest is not reportab
under section 6050H and this sectio
Similarly, if a real estate develop
pays a lump sum to the interest recip
ent for interest on a purchaser's mo
gage, this interest is not reportable u
der section 6050H and this section.
addition, amounts received by the int
est recipient as housing assistance pa
ments from the Department of Housi
and Urban Development ("HUD") on
borrower's mortgage that is insured u
der section 235 of the National Hou
ing Act (12 U.S.C. §§1701-171
(1982 & Supp. 1983)) shall not be r
ported as interest received from t
borrower. In such a case, therefor
only the amount of interest received
the mortgage that exceeds the amou
of housing assistance payments r
ceived from HUD shall be reported.

Q-15a: If an interest recipient r
ceives, with respect to a borrowe
mortgage, an amount from a gover
mental unit, or any agency or inst
mentality thereof (other than an amou
received from HUD as described
A-15 of this section), should the int

est recipient report the amount as received from the borrower?

A-15a: If the interest is received after December 31, 1986, it must be reported in the same manner as interest on mortgages with respect to which housing assistance payments are received from HUD, as described in A-15 of this section. If the interest is received before January 1, 1987, it may, but need not, be reported.

Form and manner of return

Form of return

Q-16: What form must be used to make a return required by section 6050H and this section?

A-16: An interest recipient must make the return on Form 1098 (with Form 1096 as the transmittal form). The interest recipient may, however, prepare and use a form that contains provisions substantially similar to those of Forms 1096 and 108 if that person complies with any revenue procedures relating to substitute Forms 1096 and 1098 in effect at that time. A separate return must be made for each mortgage with respect to which $600 or more of interest is received for a calendar year.

Information included on return

Q-17: What information must an interest recipient include on Form 1098?

A-17: An interest recipient must include the following information on the Form 1098:

(a) The name, address, and TIN (as defined in section 7701(a)) of the payor or payor of record;

(b) The name and address of the interest recipient;

(c) The amount of interest (not including points and other prepaid interest) received on the mortgage in the calendar year; and

(d) Any other information as may be required by Form 1098 or its instructions.

Time for filing

Q-18: When must an interest recipient file the return or returns required by section 6050H and this section?

A-18: An interest recipient must file the return or returns on or before February 28 of the year following the calendar year in which the mortgage interest is received.

Place for filing

Q-19: Where must the return or returns required under section 6050H and this section be filed?

A-19: The return or returns must be filed with the same Internal Revenue Service Center where other returns of the interest recipient are filed.

Use of magnetic media

Q-20: What rules apply with respect to the use of magnetic media?

A-20: Any return required under section 6050H and this section must be filed on magnetic media to the extent required by section 6011(e) and the regulations thereunder. Any person not required by section 6011(e) to file returns on magnetic media may requrest permission to do so. See §1.9101 for rules relating to permission to submit information on magnetic tape or other media. If a person required to file returns on magnetic media fails to do so, the penalty under section 6652 (failure to file an information return) applies.

Requirement of furnishing statements to payors

In general

Q-21: What statements are required to be furnished to payors under section 6050H and this section?

A-21: Any interest recipient required to make an information return under section 6050H must also furnish a statement to the payor or, if applicable, payor of record (see A-13 and A-14 of this section). For the date when the statement must be furnished, see A-26 of this section.

Q-22: Is the statement considered to be furnished to the payor or payor of record if it is mailed to him at his last known address?

A-22: Yes.

Q-23: If an interest recipient furnishes a statement required under a Federal mortgage program will the requirements of A-21 of this section be met?

A-23: Yes, if the statement furnished contains all the information required under A-24 of this section and is furnished to the payor or payor of record by the date required under A-26 of this section.

Information included on statement

Q-24: What information must be included on the statement required to be furnished to payors or payors of record under section 6050H and this section?

A-24: The statement must include the following information:

(a) The information required under A-17 of this section;

(b) A legend starting that the information is being reported to the Internal Revenue Service; and

(c) A legend stating that the amount reported on the statement is deductible by the payor for Federal income tax purposes only to the extent the payor actually paid the amount and was not reimbursed by another person.

Copy of Form 1098 to payors

Q-25: Can an interest recipient meet the requirement to furnish a statement to a payor or payor of record by furnishing a copy of the Form 1098 filed with respect to that payor or payor of record?

A-25: Yes. The requirement of furnishing a statement may be met by furnishing to the payor or payor of record a copy of the Form 1098 containing the same information filed with the Service with respect to such payor, or a form that contains provisions substantially similar to those of Form 1098, provided that the form bears the legends described in A-24 of this section.

Time for furnishing statement

Q-26: When is a statement required to be furnished by an interest recipient to the payor or payor of record?

A-26: A statement is required to be furnished by the interest recipient to the payor or payor of record on or before January 31 of the year following the calendar year in which the mortgage interest is received.

Penalties

In general

Q-27: Are there any penalties for failing to comply with the requirements of section 6050H and this section?

A-27: Yes. The penalty for failing to make an information return with respect to a payor or payor of record is provided in section 6652. The penalty for failing to furnish a statement to a payor or payor of record is provided in section 6678.

Q-28: Are there any penalties for failing to furnish a TIN upon request?

A-28: Yes. Any payor or payor of record is subject to a $50 penalty by the Internal Revenue Service if such

payor fails to furnish his TIN upon the request of an interest recipient. For rules relating to the requesting of TINs by interest recipients, see A-30 and A-31 of this section.

Q-29: Is an interest recipient subject to any penalties for failing to furnish the TIN of a payor or payor of record?

A-29: Yes. In general, the penalties provided under section 6676 will be assessed against interest recipients who fail to furnish to the Internal Revenue Service the TIN of a payor or payor of record. With respect to mortgages in existence on December 31, 1984, however, the interest recipient will not be subject to the section 6676 penalties if the interest recipient followed the rules of A-30 and A-31 of this section for requesting TINs and properly and promptly processed the responses.

Requesting TINS

Q-30: What rules apply with respect to the requesting of TINs by interest recipients?

A-30: With respect to obligations incurred after December 31, 1984, the interest recipient must take all reasonable steps to obtain the TIN of the payor or payor of record at the time the obligation is incurred. With respect to any mortgage for which the interest recipient does not have the TIN of the payor or payor of record in its accounting system, the interest recipient must request, at least once a year, the TIN of such payor.

The request for a TIN need not be in a separate mailing. The request may be included, for example, in the interest recipient's regular mailings of payment coupon booklets or annual statements. However, if the interest recipient makes no other mailings to the payor or payor of record during 1985 (or during the year in which the obligation is incurred for obligations incurred after 1985), then the interest recipient must request the TIN in a separate mailing.

Q-31: What form must the interest recipient use to request the TIN of a payor or a payor of record?

A-31: No particular form must be used to request the TIN. However, the request must be made on a separate piece of paper and the request must clearly notify the payor that the Internal Revenue Service requires the payor to furnish his TIN in order to verify any deduction for mortgage interest. The interest recipient must also notify such payor that he is subject to a $50 penalty, imposed by the Internal Revenue Service, if he fails to furnish his TIN.

Effective date

Q-32: When are section 6050H and this section effective?

A-32: Section 6050H and this section are generally effective for amounts of mortgage interest received after December 31, 1984. However, Q/A-15a of this section is effective for amounts of mortgage interest received after December 31, 1986.

OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

(26 CFR Part 602)

Par. 3. Section 602.101(c) is amended by inserting in the appropriate place in the table "§1.6050H-1T . . . 1545-0901."

There is need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

(Approved by the Office of Management and Budget under control number 1545-0901)

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved August 9, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 16, 1985, 8:45 a.m., and published in the issue of the Federal Register for August 20, 1985, 50 F.R. 33529)

Subpart C.—Information Regarding Wages Paid Employees

Section 6053.—Reporting of Tips

26 CFR 31.6053-3: Reporting by certain large food or beverage establishments with respect to tips.

T.D. 8039

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER C.—PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE; PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Employee Tip Reporting and Substantiation Requirements

AGENCY: Internal Revenue Service Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provide temporary regulations relating to em ployee tip reporting and substantiatio requirements. The text of the temporar regulations set forth in this documer also serves as the text of the propose regulations cross-referenced * * * [o page 811, this Bulletin]. The temporar regulations reflect amendments to th Internal Revenue Code of 1954 with re spect to tipped employees made by sec tion 1072 of the Tax Reform Act o 1984 [Pub. L. 98-369, 1984-3 C.B (Vol. 1) 1, 560] and provide guidanc to employers and employees with re spect to the new provisions.

DATES: The regulations contained i this document in §31.6053-3T(h) wi respect to a lower allocation-of-tip percentage are to be effective on an after July 18, 1984. The provisions o §31.6053-3T(j)(9) relating to the def nition of a large food or beverage e tablishment are effective for taxab years beginning after December 3 1982. The substantiation requiremen contained in §31.6053-3T(b)(5) an §31.6053-4T are effective with respe to tips received on or after October 1985.

FOR FURTHER INFORMATIO CONTACT: Gail H. Morse of the Le islation and Regulations Division, O fice of Chief Counsel, Internal Reven Service, 1111 Constitution Ave N.W., Washington, D.C. 20224 (A tention: CC:LR:T) (202-566-3297, n a toll-free call).

SUPPLEMENTARY INFORMATIO

BACKGROUND

Under current law, all employe who receive cash tips of $20 or more a calendar month are required to rep such tips to their employers for pu poses of income, social security, a railroad retirement tax withholding r quirements. To increase complian

with this requirement, the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) [Pub. L. 97-248, 1982-2 C.B.462] provided rules which, under certain circumstances, require large food and beverage establishments to file an information report setting forth an allocation of tip amounts. Generally, whenever the employees of a large food or beverage establishment fail to report to their employer tips aggregating 8 percent or more of the gross receipts of an establishment, the employer must allocate to the employees (as tips for purposes of section 6053(c)) an amount equal to the difference between 8 percent of the establishment's gross receipts and the aggregate amount of tips reported by the employees. The Secretary of the Treasury is authorized to reduce the allocation figure based on a showing by an employer that the tip rate for its particular establishment was lower than 8 percent. Under the provisions enacted in TEFRA, the rate could not be lower than 5 percent. The TEFRA rules were amended by Section 1072 of the Tax Reform Act of 1984 (the Act) (98 Stat. 1052, 26 U.S.C. 6053 note) to allow a majority of employees to petition for a reduced allocation rate and to permit a minimum allocation rate of 2 percent. In addition, the Act provides that for purposes of determining whether an establishment normally employed more than 10 employees and thus was a large food or beverage establishment, an individual who owns 50 percent or more in value of the stock of a corporation operating a food or beverage establishment is not considered an employee of such establishment. The Act also directed the Secretary to promulgate regulations with respect to recordkeeping requirements applicable to tipped employees.

The temporary regulations contained herein would provide guidance to employers and employees with respect to the provisions of section 1072 of the Act.

EXPLANATION OF PROVISIONS

The temporary regulations reflect amendments to section 6053 with respect to the reduction of the minimum allocation rate from 5 percent to 2 percent (§31.6053-3T(h)(1)) and with respect to the treatment of 50-percent stockholders as nonemployees (§31.6053-3T(j)(9)).

In addition, the temporary regulations provide rules with respect to employee-originated petitions for a reduction in the tip allocation rate. Section 31.6053-3T(h)(2) provides that employee-originated petitions must be consented to by a majority of employees, which, for this purpose, means more than one-half of the directly tipped employees employed by the establishment at the time the petition is filed. Further requirements of employee-originated petitions are set forth in §31.6053-3T(h)(2)(iii), including a requirement that employers provide (in confidence) certain information to the district director.

In addition to the general recordkeeping requirements applicable to all taxpayers, these temporary regulations, in response to the congressional mandate to promulgate regulations with respect to recordkeeping requirements applicable to tipped employees, provide rules specifically applicable to tipped employees. Under the temporary regulations, an employee is required to maintain sufficient evidence to establish the amount of tip income received by the employee during a taxable year. The temporary regulations provide that sufficient evidence consists of either (i) a daily record, or (ii) other evidence of the tip income received which is as credible and as reliable as a daily record (§31.6053-4T). The daily record or other evidence may not be sufficient evidence if there are facts and circumstances which indicate that the employee received a larger amount of tip income (§31.6053-4T).

The effective date for these substantiation regulations is October 1, 1985. However, under the general recordkeeping provisions of section 6001 and the regulations thereunder tipped employees are required, for periods prior to that date, to have books and records adequate to substantiate the amount of tip income received. Substantiation considered sufficient as provided in these temporary regulations will also be considered sufficient for such prior periods.

REGULATORY FLEXIBILITY ACT; EXECUTIVE ORDER 12291; PAPERWORK REDUCTION ACT OF 1980

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for temporary regulations. Accordingly, the Regulatory Flexibility Act does not apply and no Regulatory Flexibility Analysis is required for this rule. The Commissioner of Internal Revenue has determined that this temporary rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not requied. The reporting requirements added by this document have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. The reporting requirements have been approved by OMB.

DRAFTING INFORMATION

The principle author of these temporary regulations is Gail H. Morse of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue and Treasury Department participated in developing the regulations both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations.

Accordingly, 26 CFR Part 1 and Part 602 are amended as follows:

PART 31 EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Paragraph 1. The authority for Part 31 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * Sections 31.6053-3T and 31.6053-4T are also issued under section 1072 of Pub. L. 98-369, 98 Stat. 1052 [1984-3 C.B. (Vol. 1), 1, 560]; and 26 U.S.C. 6001.

Par. 2. Section 31.6053-3 is amended by revising paragraphs (b)(5), (h), and (j)(9) to read as set forth below:

§31.6053-3 Reporting by certain large food or beverage establishments with respect to tips.

* * * * *

(b) *Employer statement to employees.* * * *

(5) See paragraph (b)(5) of §31.6053-3T.

* * * * *

(h) *Lowering the percentage to be used.* See paragraph (h) of §31.6053-3T.

* * * * *

(j) *Definitions.* * * *

(9) *More than 10 employees on a typical business day.* See paragraph (j)(9) of §31.6053-3T.

Par. 3. A new §31.6053-3T is added immediately following §31.6053-3 to read as follows:

§31.6053-3T Reporting by certain large food or beverage establishments with respect to tips. (Temporary)

(a) [RESERVED]

(b) *Employer statement to employees*—(1)-(4) [RESERVED]

(5) *Employee reporting of tip income.* Regardless of whether an employee receives an allocation under section 6053(c) and §31.6053-3, the employee is required to report as income on his or her Federal income tax return all tips received. For tips received before October 1, 1985, an employee must be able to substantiate the amount of reported tip income as provided in section 6001 and the regulations thereunder. For tips received on or after October 1, 1985, an employer must be able to substantiate the amount of reported tip income as provided in §31.6053-4T. The Internal Revenue Service may determine that a tipped employee received a larger amount of tip income than is reflected by the employee's allocation.

(c)–(g) [RESERVED]

(h) *Lowering the percentage to be used*—(1) *In general.* On and after July 18, 1984, an employer or a majority of the employees (as defined in paragraph (h)(2)(iii) of this section) of an employer may petition the district director for the internal revenue district in which the employer's establishment is located to have the percentage of gross receipts that is used to determine the amount to be allocated under section 6053(c)(3)(A) and paragraph (d) of §31.6053-3 reduced from 8 percent to the percentage that the petitioning employer or employees believe to be the actual percentage of the amount of the establishment's gross receipts that reflects the amount of tips. The district director may thereafter reduce the percentage of gross receipts used to determine the amount to be so allocated to the percentage that the district director determines to be the proper estimate of the actual percentage of gross receipts constituting tips. The district director, however, may not reduce the percentage below 2 percent. For the rules in effect prior to July 18, 1984, see 26 CFR §31.6053-3(h) (Rev. as of April 1, 1984).

(2) *Time and manner for petition to have percentage reduced*—(i) *In general.* The petition shall be in writing and shall include sufficient information to allow the district director to estimate with reasonable accuracy the actual tip rate of the establishment. For example, such information might include the charged tip rate, the type of establishment, menu prices, the location of the establishment, the amount of "self-service" required, the days and hours open for business, and whether the customer receives the check from or pays the server for the meal.

(ii) *Employer petitions.* In the case of employer-originated petitions, the employer has the burden of supplying sufficient information to allow the district director to estimate with reasonable accuracy the actual tip rate of the establishment. The employer also shall attach to the petition copies of Form 8027 (if any) filed for the establishment for the 3 immediately preceding calendar years.

(iii) *Employee petitions.* (A) In the case of employee-originated petitions, a majority of the employees of an establishment must consent to the petition. A majority for purposes of this paragraph is more than one-half of all the directly tipped employees (within the meaning of paragraph (j)(12) of §31.6053-3) employed by the establishment at the time the petition is filed. In the case of a single petition for certain multi-establishment employers (see paragraph (h)(4) of this section), more than onehalf of the aggregate directly tipped employees (at the time the petition is filed) of the establishments covered by the petition must consent. The petition filed with the district director must state the total number of directly tipped employees employed by the establishment (or establishments) and the number of the directly tipped employees consenting to the petition.

(B) The petitioning employees have the burden of supplying sufficient information to allow the district director to estimate with reasonable accuracy the actual tip rate of the establishment to the extent they possess such information. If the employer possesses relevant information, the employer must provide such information to the district director upon the request of the petitioning employees or district director. Employees who file a petition under this paragraph must promptly notify their employer of the petition. Promptly upon receipt of such notification, their employer must submit to the district director copies of the Form 8027 (if any) filed for the establishment for the 3 immediately preceding calendar years. Any information supplied by the employer during the petitioning process shall not be disclosed by the Internal Revenue Service to any employees of the employer nor to representatives of such employees.

(3) *Effective date for reduced percentage.* The district director shall determine the term for which the reduced percentage is to be effective. At the end of such term, the reduced percentage shall cease to apply unless previously extended by the district director for the district in which the large food or beverage establishment is located. In no event shall the reduced percentage be applied to payroll periods before the date the petition described in paragraph (h)(2) of this section is filed unless the establishment is a new business (as described in paragraph (i) of §31.6053-3). In the case of a new business or a petition for reduction filed prior to September 30, 1983, the district director may allow the approved reduced percentage to be applied retroactively to the first day of the calendar year of the petition. Until such time as the employer is notified in writing by the district director of approval of a reduction, the employer must continue to use 8 percent of gross receipts for purposes of complying with section 6053 (c) and this section.

(4) *Single petition for certain multi-establishment employers.* An employer (including a single employer as defined in section 52(a) or (b)) or a majority of the employees of such employer may

use a single petition for two or more of the employer's establishments if such establishments are essentially the same type of business, the petitioning employer or employees have made a good faith determination that the tip rates at such establishments are essentially the same, and the establishments are located in the same internal revenue region. Single petitions shall include the names and locations of the establishments for which a reduction is requested and the information required by paragraph (h)(2) of this section for a typical establishment. A single petition for multi-establishments located within an internal revenue region shall be filed with the district director for the internal revenue district in which the greatest number of the establishments included in the petition are located. If there is an equal number of establishments located in two or more internal revenue districts the employer or employees petitioning may choose the district to which the petition is sent.

(i) [RESERVED]

(j) *Definitions*—(1)-(8) [RESERVED]

(9) *More than 10 employees on a typical business day.* An employer shall be considered to have normally employed more than 10 employees on a typical business day during a calendar year if one half of the sum of the average number of employee hours worked per business day during the calendar month in which the aggregate gross receipts from food or beverage operations were the greatest plus the average number of employee hours worked per business day during the calendar month in which the aggregate gross receipts from food or beverage operations were the least, is greater than 80 hours. The average number of employee hours worked per business day during a month shall be computed by dividing the total number of hours worked during the month by all employees of the employer who are employed in a food or beverage operation by the average of the number of days during the month that each food or beverage operation at which such employees worked was open for business. If an employer operates both a food or beverage operation and a nonfood or beverage operation, and one or more of his or her employees work for both operations, the employer may make a good faith estimate of the number of hours such employees worked for each operation in a given month. Similarly, in cases where one or more of an employer's employees work for more than one of such employer's food or beverage operations, a good faith estimate may be made of the number of hours such employees worked for each operation in a given month. For purposes of this subparagraph, employees who are employed in a food or beverage operation include all employees of the operation, not just food or beverage employees. The employees of an employer shall include all employees at all food or beverage operations who, along with the employees of such employer, would be treated as employees of a single employer under section 52(a) or (b) (as in effect on September 3, 1982) and the regulations thereunder. For example, if an employer at a food or beverage operation is a member of a controlled group of corporations, then all employees of all corporations which are members of such controlled group of corporations shall be treated as employed by each such employer for purposes of this paragraph. However, an individual who owns 50 percent or more in value of the stock of a corporation operating an establishment shall not be treated as an employee of any establishment owned by the corporation.

Par. 4. A new §31.6053-4T is added immediately after §31.6053-3T to read as follows:

§31.6053-4T Substantiation requirements for tipped employees. (Temporary)

(a) *Substantiation of tip income*—(1) *In general.* An employee shall maintain sufficient evidence to establish the amount of tip income received by the employee during a taxable year. A daily record maintained by the employee (as described in paragraph (a)(2) of this section) shall constitute sufficient evidence. If the employee does not maintain a daily record, other evidence of the amount of tip income received during the year, such as documentary evidence (as described in paragraph (a)(3) of this section), shall constitute sufficient evidence, but only if such other evidence is as credible and as reliable as a daily record. However, notwithstanding any other provision of this paragraph (a)(1), a daily record or other evidence that is as credible and as reliable as a daily record may not be sufficient evidence if there are facts or circumstances which indicate that the employee received a larger amount of tip income. Moreover, oral statements of the employee, without corroboration, cannot constitute sufficient evidence.

(2) *Daily record.* The daily record shall state the employee's name and address, the employer's name, and the establishment's name. The daily record shall show for each work day the amount of cash tips and charge tips received directly from customers or from other employees, and the amount of tips, if any, paid out to other employees through tip sharing, tip polling or other arrangements and the names of such employees. The record shall also show the date that each entry is made. Form 4070A, *Employee's Daily Record of Tips,* may be used to maintain such daily record. The daily record of tips received by an employee shall be prepared and maintained in such manner that each entry is made on or near the date the tip income is received. A daily record made on or near the date the tip income is received has a high degree of credibility not present with respect to a record prepared subsequent thereto when generally there is a lack of accurate recall. An entry is made "near the date the tip income is received" if the required information with respect to tips received and paid out by the employee for the day is recorded at a time when the employee has full present knowledge of those receipts and payments.

(3) *Documentary evidence.* Documentary evidence consists of copies of any documents that contain (i) amounts that were added to a check by customers as a tip and paid over to the employee or (ii) amounts that were paid by a customer for food or beverages with respect to which tips generally would be received by the employee. Examples of documentary evidence are copies of restaurant bills, credit card charges, or charges under any other arrangement (see §31.6053-3(j)(4)) containing amounts added by the customer as a tip.

(b) *Retention of records.* Records maintained under this section shall be

kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.

(c) *Effective date.* The substantiation requirements of this §31.6053-4T shall be effective for tips received on or after October 1, 1985. For the rules in effect prior to October 1, 1985, see section 6001 and the regulations thereunder. Substantiation considered sufficient as provided in this §31.6053-4T will also be considered sufficient for tips received before October 1, 1985.

PART 602
OMB CONTROL NUMBERS
UNDER THE PAPERWORK
REDUCTION ACT

Par. 5. The authority for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 6. Section 602.101(c) is amended by inserting in the appropriate places in the table "§31.6053-3T and §31.6053-4T . . . 1545-0065."

* * * * *

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

ROSCOE L. EGGER, JR.
Commissioner of
Internal Revenue.

Approved July 12, 1985.

J. ROGER MENTZ,
Acting Assisting Secretary
of the Treasury.

(Filed by the Office of the Federal Register on July 18, 1985, 4:06 p.m., and published in the issue of the Federal Register for July 23, 1985, 50 F.R. 29964)

Part V.—Time for Filing Returns and Other Documents

Section 6071.—Time for Filing Returns and Other Documents

26 CFR 48.6071(a)-1: Time for filing returns.

Time for filing quarterly, monthly, and semimonthly returns required under section 48.6011(a)-1(a) of the regulations. See T.D. 8043, page 214.

Part VI.—Extension of Time for Filing Returns

Section 6081.—Extension of Time for Filing Returns

26 CFR 1.6081-1T: Extension of time to file return in case of taxpayers with mixed straddles (temporary).

Due date for filing return for taxpayers holding one or more mixed straddles within the meaning of section 1092(b)(2). See T.D. 8058, page 183.

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26 CFR 48.6081(a)-1: Extension of time for filing returns.

Application for extension of time with respect to taxes imposed by section 4041, 4042, 4051, and chapter 32 of the Code. See T.D. 8043, page 214.

Part VII.—Place for Filing Returns or Other Documents

Section 6091.—Place for Filing Returns or Other Documents

26 CFR 48.6091-1: Place for filing returns.

Place for filing returns of persons other than corporations, returns of corporations, and returns of persons outside the United States. See T.D. 8043, page 214.

Subchapter B.—Miscellaneous Provisions

Section 6103.—Confidentiality and Disclosure of Returns and Return Information

Instructions for federal and state agencies requesting taxpayer address information and for federal agencies requesting tax delinquent account status indicators from the Service. See Rev. Proc. 85-33, page 414.

Section 6107.—Index Tax Return Preparer Must Furnish Copy of Return to Taxpayer and Must Retain a Copy or List

26 CFR 1.6107-1: Income tax return preparer must furnish copy of return to taxpayer and must retain a copy or record.

Whether the requirements of section 6107 of the Code apply to a firm that furnishes a computerized tax return preparation service to tax practioners. See Rev. Rul. 85-187, page 338.

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26 CFR 1.6107-1: Income tax return preparer must furnish copy of return to taxpayer and must retain a copy or record.

Whether the requirements of section 6107 of the Code apply to a farmers cooperative credit association that prepares Schedule F of Form 1040. See Rev. Rul. 85-188, page 339.

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26 CFR 1.6107-1: Income tax return preparer must furnish copy of return to taxpayer and must retain a copy or record.

Whether the requirements of section 6107 of the Code apply to a person who prepares a computer program and sells it to a taxpayer to use in preparing the taxpayer's income tax return. See Rev. Rul. 85-189, page 341.

Section 6109.—Identifying Numbers

26 CFR 1.6109-2: Furnishing identifying number of income tax return preparer.

Whether the requirements of section 6109(a)(4) of the Code apply to a firm that furnishes a computerized tax return preparation service to tax practitioners. See Rev. Rul. 85-187, page 338.

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26 CFR 1.6109-2: Furnishing identifying number of income tax return preparer.

Whether the requirements of section 6109(a)(4) of the Code apply to a farmers cooperative credit association that prepares Schedule F of Form 1040. See Rev. Rul. 85-188, page 339.

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26 CFR 1.6109-2: Furnishing identifying number of income tax return preparer.

Whether the requirements of section 6019(a)(4) of the Code apply to a person who prepares a computer program and sells it to a taxpayer to use in preparing the taxpayer's income tax return. See Rev. Rul. 85-189, page 341.

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26 CFR 48.6109-1: Employer identification numbers.

Employer identification number required for every person who makes a sale or use of an article with respect to which a tax is imposed by section 4041, 4042, or 4051 or chapter 32 of the Code. See T.D. 8043, page 214.

Chapter 62.—Time and Place for Paying Tax
Subchapter B.—Extensions of Time for Payment

Section 6161.—Extension of Time for Paying Tax

26 CFR 48.6161(a)-1: Extension of time for paying tax shown on return.

Application for extension of time for payment of tax imposed by section 4041, 4042, or 4051 or chapter 32 of the Code. See T.D. 8043, page 214.

Chapter 63.—Assessment
Subchapter A.—In General

Section 6206.—Special Rules Applicable to Excessive Claims under Sections 6420, 6421, and 6427

26 CFR 48.6206-1: Assessment and collection of excessive payment and penalty.

Treatment of excessive claims with respect to the use of certain gasoline. See T.D. 8043, page 214.

Subchapter C.—Tax Treatment of Partnership Items

Section 6232.—Extension of Subchapter to Windfall Profit Tax

26 CFR 51.6232(a)-1: Partnership items for windfall profit tax purposes determined at the partnership level.

T.D. 8054

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 51—EXCISE TAX REGULATIONS UNDER THE CRUDE OIL WINDFALL PROFIT TAX ACT OF 1980

Tax Treatment of Partnership Items for Windfall Tax Purposes

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the treatment of partnership items for purposes of the windfall profit tax. The Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462] changed the applicable law. The regulations provide guidance to partnerships with oil production subject to windfall profit tax, their partners, and Internal Revenue Service personnel.

DATES: The regulations extending the rules for consolidated partnership proceedings to windfall profit tax (§51.6232(a)-1) and setting out the definition of partnership items (§51.6232(a)-2) are effective for taxable periods beginning after December 31, 1982.

The final regulations relating to elections with respect to the authority of the partnership to act on behalf of partners are effective for taxable periods beginning after December 31, 1984.

FOR FURTHER INFORMATION CONTACT: Nerman Dobynes Hubbard of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) 202-566-3289, not a toll-free number.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On October 18, 1984, the FEDERAL REGISTER published proposed amendments to the Excise Tax Regulations under the Crude Oil Windfall Profit Tax Act of 1980 (26 CFR Part 51) [Pub. L. 96-223, 1980-3 C.B. 1] under section 6232 of the Internal Revenue Code of 1954 (49 FR 40896) [LR-220-83, 1984-2 C.B. 887]. Section 6232 relates to the extension of the partnership audit rules under sections 6221 through 6231 to the windfall profit tax and to the authority of a partnership to act on behalf of its partners in the determination, assessment, and collection of windfall profit tax. The amendments were proposed to conform the regulations to the changes made to the Internal Revenue Code by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462, 585].

Two written comments were received on the proposed regulations. No public hearing was held because the one request for a hearing was withdrawn. The most significant points raised by the comments are discussed in the remainder of the preamble. After consideration of all comments regarding the proposed amendments, those amendments are adopted as modified by this Treasury decision.

PARTNERSHIPS SUBJECT TO CONSOLIDATED PROCEEDINGS FOR WINDFALL PROFIT TAX PURPOSES

Sections 6221 through 6231 apply generally to all partnerships required to file partnership returns for income tax purposes except certain small partnerships described in section 6231(a)(1)(B). Those sections provide for consolidated partnership-level proceedings with respect to items treated under regulations as "partnership items" for income tax purposes.

Under section 6232, these provisions for consolidated partnership-level proceedings also apply, with certain modifications, with respect to items treated under regulations as "partnership items" for windfall profit tax purposes. If the rules for consolidated partnership-level proceedings apply with respect to a partnership for income tax purposes, they will also apply with respect to the partnership for windfall profit tax purposes whether or not the partnership chooses to act on behalf of the partners under section 6232(c).

These final regulations modify proposed §51.6232(a)-1(2) to alleviate a potential administrative burden on the Service. The Austin Service Center, which will be processing windfall profit tax data received from partnerships, will not receive income tax data from all partnerships. Accordingly, final §51.6232(a)-1(2) provides that if the Service determines that it is impractical to use information furnished to the Service for income tax purposes for windfall profit tax purposes, the tax matters partner must furnish to the Service any information requested by it for purposes of the windfall profit tax proceedings.

RESPONSE TO COMMENTS

It was suggested that the term "partnership item" be defined for windfall profit tax purposes to include the category of crude oil. In response to this comment, the Service has included in final §51.6232(a)-2(b)(1) a parenthetical to make clear that the category of crude oil is a partnership item to the extent that it is determinable at the partnership-level.

Another suggestion was that the regulations make clear that any interest allowed on an overpayment of windfall profit tax to be refunded to an electing partnership under section 6232(c) be paid to the partnership. The final regulations adopt this suggestion and provide that the partnership is entitled to any interest due with respect to any overpayment of tax. The regulations also provide that the partnership must pay any interest due with respect to any underpayment of such tax.

There was also a request for clarification as to the partnership return to be referred to for purposes of section 6611(h)(1). Section 6611(h)(1) provides that no interest will be allowed on an overpayment of tax imposed by section 4986 if the overpayment is refunded within 45 days after the later of the due date (determined without regard to any extension of time) for the return for the taxable period with respect to which the overpayment was made or the date the return was actually filed. The regulations make clear that the applicable partnership return for purposes of section 6611(h)(1) is the partnership's "first" Form 6248 which is required to be filed by the partnership

with the Service for the removal year to which the return relates. The last day for filing the "first" Form 6248 (determined without regard to extensions) is May 31 of the first year following the close of the removal year in which the crude oil is removed.

Both comments on the proposed regulations pointed to the need to clarify the term "adjustment" as used in §51.6232(c)-1 by distinguishing between "liability" adjustments and "withholding" adjustments.

Under final §51.6232(c)-1(b)(3), the partnership is to furnish to the Service Form 6248 which shows the amount of windfall profit tax allocable to the partner that was actually withheld and paid during the removal year and any adjustment made, that is, any tax paid or any refund claimed, by the partnership with respect to that partner to eliminate any underpayment or overpayment that would otherwise appear on the Form 6248. Once this adjustment is made, the Form 6248 will reflect the windfall profit tax liability of the partner as computed by the partnership. This is a "liability" adjustment.

Generally, the purchaser of crude oil is required to withhold from its payments made to the producer the amount of windfall profit tax imposed on the producer. If withholding errors are discovered by the purchaser during the removal year, the purchaser must make adjustments in the amount to be withheld from subsequent payments to the same person. However, no adjustments may be made by the purchaser after the annual return (Form 6248) is furnished to the producer. These adjustments are "withholding" adjustments.

A partnership that elects to represent its partners ordinarily may make only "liability" adjustments. The partnership may make "withholding" adjustments only if the partnership is a qualified disburser. The final regulations make this clear by cross references to the provision describing "liability" adjustments. Because one commentator construed the references in the proposed regulations to a "claim for credit or refund" filed by the partnership as indicating that a partnership was permitted to seek "withholding" adjustments (other than those that it could make as a qualified disburser), the final regulations refer only to a "claim for refund" filed by the partnership.

Finally, one commentator questioned the limitation placed on partners under proposed §51.6232(c)-1(b)(5). Under this provision, a partner for whom the partnership is acting is not entitled to participate in any administrative or judicial proceedings or to receive notices or other information as to those procedings; thus, the tax matters partner is not required to keep the partners informed of the proceedings. The commentator noted that section 6232(c)(3) provides that none of the rights granted to partners under sections 6221 through 6231 are lost by virtue of the partnership's authority to act on behalf of all partners. The Service believes that the rights of the partner are sufficiently protected by the availability of an election not to be represented by the partnership. Any partner who wishes to participate personally in partnership-level proceedings may make this election and so preserve the partner's right to notices, etc. If partners who do not choose to make this election were still entitled to notices, however, the Service and the partnership would labor under a paperwork burden that section 6232(c)(1) was intended to eliminate.

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

The Secretary of the Treasury has certified that this regulation will not have a significant economic impact on a substantial number of small entities. The regulation attempts to limit the paperwork burden to the minimum necessary to ensure that partners are aware of their rights and that the Service is able to administer the law efficiently. The paperwork burden will be substantial only for partnerships that have a very large number of partners. Accordingly, these proposed regulations are not subject to the requirements of the Regulatory Flexibility Act of 1980 (5 U.S.C. Chapter 6).

The Commissioner of Internal Revenue has determined that this regulation is not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis is therefore not required.

PAPERWORK REDUCTION ACT

The collection of information requirements contained in this regulation have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these regulations is Nerman Dobynes Hubbard of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations.

Accordingly, the Excise Tax Regulations under the Crude Oil Windfall Profit Tax Act of 1980 (26 CFR Part 51) and the OMB Control Number under the Paperwork Reduction Act (26 CFR Part 602) are amended as follows:

Paragraph 1. The authority for Part 51 is amended by adding the following citation:

Authority: 26 U.S.C. 7805 * * * Sections 51.6232(a)-1, 51.6232(a)-2, and 51.6232(c)-1 through 51.6232(c)-5 also issued under 26 U.S.C. 6232.

Par. 2. In part 51, new §§51.6232(a)-1, 51.6232(a)-2, and 51.6232(c)-1 through 51.6232(c)-5 are added in the appropriate place to read as follows:

§51.6232(a)-1 Partnership items for windfall profit tax purposes determined at the partnership level.

(a) *Sections 6221 through 6231 of the Code made applicable to windfall profit tax*—(1) *In general.* Except as otherwise provided in §§51.6232(c)-1 through 51.6232(c)-5 or this section, the rules and procedures for determining the tax treatment of partnership items for income tax purposes as set forth in sections 6221 through 6231 of the Code and the regulations under those sections shall apply in determining the treatment of partnership items (as defined in §51.6232(a)-2) for windfall profit tax purposes. For example, the partner who is the tax matters part-

ner for income tax purposes shall also be the tax matters partner for windfall profit tax purposes.

(2) *Information furnished for income tax purposes shall be used for windfall profit tax purposes.* Information furnished to the Service for income tax purposes by the tax matters partner or any other person under sections 6221 through 6231 (for example, information furnished to identify a previously unidentified partner or information furnished to determine whether the partner is entitled to notice) shall be used to the extent practical for windfall profit tax purposes. If the Service determines that it is impractical to use the information furnished for income tax purposes, however, the tax matters partner shall furnish to the service any information requested by the Service for purposes of the windfall profit tax proceedings.

(3) *Periods of limitation.* The period of limitation for filing a request for an administrative adjustment of, or for assessing any tax attributable to, any partnership item for purposes of the windfall profit tax shall be determined under section 6227 or 6229, except that any reference to the partnership return shall mean the "first" Form 6248 which is required to be filed by the partnership with the Service for the removal year to which the return relates and the reference to "subtitle A" in section 6229 shall mean "Chapter 45 of subtitle D." The last day for filing the "first" Form 6248 (determined without regard to extensions) shall be May 31 of the first year following the close of the removal year in which the crude oil was removed. See §51.6232(c)-1(b)(3) and (7) for extension of time to June 30 for taking certain actions.

(4) *Request for administrative adjustment*—(i) *In general.* Any claim for credit or refund or any return with respect to any overpayment or underpayment of windfall profit tax on partnership production shall be treated as a request for administrative adjustment treated as a request for administrative adjustment within the meaning of section 6227 to the extent that the claim or return treats any partnership item in a manner that is inconsistent with the treatment of that item on the "first" Form 6248 filed by the partnership. Thus, for example, section 6228 applies in determining when a partner may file suit if the request for adjustment is not allowed.

(ii) *Certain rules as to form disregarded.* Requirements that a request for administrative adjustment for income tax purposes be filed on a particular form or in a particular manner do not apply in the case of a request for administrative adjustment for windfall profit tax purposes. The partnership or the partner may file a claim for credit or refund, or a return, of windfall profit tax with respect to partnership production in the same manner as a claim or return with respect to nonpartnership production.

(b) *Other windfall profit tax regulations remain applicable.* Except to the extent otherwise provided in §§51.6232(c)-1 and 51.6232(c)-5, the partnership and each partner shall comply with the requirements set forth in other provisions of this part or in Part 150 of this chapter for furnishing information, filing returns, paying additional tax, or claiming a credit or refund. For example, a partnership that does not make an election to represent partners under section 6232(c) shall furnish to partners and file with the Service the Form 6248 in the time and manner prescribed in §51.4997-2.

(c) *Income tax deduction for windfall profit tax paid.* The partner shall take the partner's share of the windfall profit tax paid or withheld with respect to partnership removed during the removal year as reported by the partnership into account in determining the partner's income tax deduction for windfall profit tax paid during that year. In making that determination the partner shall also take into account any statement received from the partnership regarding any additional windfall profit tax paid, or any credit or refund of windfall profit tax received, during that removal year by the partnership on behalf of that partner with respect to any earlier removal year. If the partnership, as a result of receiving additional information, furnishes the partner a revised statement with respect to the amounts described above, the partner shall amend the partner's income tax return (if already filed) to reflect the revisions.

(d) *Effective date.* The rules set forth in this section are applicable to taxable periods beginning after December 31, 1982.

§51.6232(a)-2 Definition of partnership item.

(a) *In general.* For purposes of Section 6232 and the regulations thereunder, the term "partnership item" means any item relating to the determination of the tax imposed by chapter 45 to the extent that such item is more appropriately determined at the partnership level than at the partner level.

(b) *Partnership items.* The following items with respect to oil removed from any property in which the partnership holds an interest are more appropriately determined at the partnership level than at the partner level and, therefore, are partnership items:

(1) the tier or tiers of the crude oil (including the category of the crude oil to the extent determinable at the partnership level),

(2) The quantity of crude oil in each tier;

(3) The adjusted base price and removal price;

(4) The severance tax adjustment;

(5) The determination of whether the oil qualifies as exempt Alaskan oil;

(6) The determination of when removal from the premises occurs and what constitutes the property;

(7) The percentage interest of each partner in the oil removed;

(8) The amount of (and each partner's share of) the windfall profit tax withheld form, or paid by, the partnership for partnership oil removed during the taxable period;

(9) The windfall profit tax liability of each partner for that partner's share of the partnership oil removed during the taxable period (computed without regard to the net income limitation and on the assumption that information furnished to the partnership by the partner with respect to the partner's status as an independent producer or exempt status is correct); and

(10) The net income limitation to the extent that the limitation can be computed at the partnership level.

(c) *Effective date.* The provisions of this section are applicable to taxable periods beginning after December 31, 1982.

§51.6232(c)-1 Partnership authorized to act on behalf of partners for a removal year beginning after 1984.

(a) *Overview of partnership authority and responsibilities*—(1) *In general.* Except to the extent otherwise provided in paragraph (a)(2) and (3) of this section, the partnership, acting through its tax matters partner, shall be authorized to act on behalf of the partners of that partnership in the determination assessment, and collection of the windfall profit tax for a removal year beginning after 1984 if the partnership elects to do so in accordance with the requirements of §51.6232(c)-2(b). If the partnership elects to act on behalf of the partners in this regard, the partnership's responsibilities to file with the Service and furnish to the partner any information, statement, or return are set forth in this section. If the partnership does not elect to act on behalf of the partner, it shall file with the Service and furnish to the partners any information, statement, or return required by other provisions of this part or by Part 150 of this chapter in the time and manner prescribed by those regulations.

(2) *Partnership authority negated by "5-percent election."* The authority of the partnership to act on behalf of the partners with respect to the windfall profit tax is negated if any partner or any group of partners who in the aggregate own at least a 5-percent interest in the income of the partnership make the election provided in §51.6232(c)-3. Paragraph (d) of this section sets out the responsibilities of the partnership in the event that a 5-percent election is made.

(3) *Partnership authority negated by "individual election."* The authority of the partnership to act on behalf of a particular partner with respect to the windfall profit tax is negated if that partner makes the election provided in §51.6232(c)-4. Paragraph (c) of this section sets out the responsibilities of the partnership with respect to a partner who makes the "individual election."

(4) *Rules applicable to partner not represented by partnership.* For rules applicable to a partner when partnership authority to act on behalf of the partner is negated by an election under §51.6232(c)-3 or §51.6232(c)-4, see §51.6232(c)-5.

(5) *Cross reference.* For rules applicable to removal years 1983 and 1984, see §150.6232(c)-1.

(b) *Partnership responsibility with respect to partner who does not elect to negate the authority of the partnership to act on its behalf*—(1) *In general.* If the partnership elects to be treated as authorized to act on behalf of the partners and no 5-percent election is made in accordance with §51.6232(c)-3, this paragraph (b) shall apply with respect to any partner who has not made an individual election under §51.6232(c)-4 to negate the authority of the partnership.

(2) *Information to be furnished to partner*—(i) *Information in lieu of 6248.* The partnership will not furnish the partner a Form 6248. Instead, the partnership shall furnish to the partner a statement indicating the partner's allocable share of the windfall profit tax paid or withheld during the removal year; see §51.6232(a)-1(c). This statement shall be furnished to the partner by the first March 31 following the removal year to which the statement relates.

(ii) *Later adjustments.* If the partnership—

(A) Pays an additional windfall profit tax, or

(B) Receives any credit or refund of windfall profit tax paid or withheld,

with respect to a partner's share of partnership production for a removal year for which the partnership is authorized to act on behalf of the partner, the partnership shall notify the partner of the adjustment so that the partner may take the amount of the adjustment into account appropriately for income tax purposes. The partnership shall provide this notice at the same time as the partnership furnishes information to the partner with respect to windfall profit tax withheld or paid during the removal year in which the adjustment occurs.

(3) *Partnership required to file Form 6248 with Service.* The partnership shall furnish a Form 6248 with respect to the partner to the Austin Service Center (at the address specified in paragraph (e) of this section) by the first June 30 following the year to which the form relates. This Form 6248 shall show the amount of windfall profit tax allocable to the partner that was actually withheld or paid during the removal year and any adjustment made by the partnership with respect to that partner under paragraph (b)(4)(i) of this section to eliminate any overpayment or underpayment. The partnership shall furnish a separate Form 6248 for each partner; the partnership is not permitted to subject an aggregate Form 6248 for all partners.

(5) *Partnership shall represent partner in all proceedings.* The tax matters partner shall represent the partner in all administrative and judicial proceedings. Therefore, the partner shall not be entitled to participate in these proceedings or to receive the notices described in section 6223(a). The tax matters partner shall not be required to keep the partner informed of administrative or judicial proceedings. However, the partnership shall furnish to the partner upon request any and all windfall profit tax information necessary for the verification of the tax computed by the partnership or the determination of the partner's entitlement to independent producer lower rates or royalty owner exemptions.

(6) *Settlement authority.* Any settlement entered into by the tax matters partner is binding on the partner. The partner is not permitted to enter into a separate settlement with the Service accordingly, the partner is not permitted to request consistent settlement terms under section 6224(c).

(7) *Extension of time for certain actions.* The provisions of paragraph (b)(3) and (b)(4) of this section that permit a return to be filed or a payment to be made later than the date otherwise prescribed for the filing of that return or the making of that payment under the Code or the applicable regulations operate as automatic extensions of the period otherwise prescribed.

(c) *Partnership responsibilities with respect to partner who has made an individual election*—(1) *In general.* If the partnership makes the election described in §51.6232(c)-2 to act on behalf of the partners and no 5-percent election is made, this paragraph (c) shall apply with respect to any partner who makes the individual election under §51.6232(c)-4 to negate the authority of the partnership.

(2) *Partnership shall furnish Form 6248.* The partnership shall furnish a Form 6248 with respect to the partner to the Austin Service Center (at the address specified in paragraph (e) of this section) and to that partner within the time period prescribed in §51.4997-

Since the partnership is not authorized to make any adjustment under paragraph (b)(4)(i) of this section to eliminate an overpayment or underpayment with respect to the partner, the Form 6248 will not show any such adjustment made by the partnership.

(3) *Partnership may not file return or claim on behalf of partner.* The partnership may not file any return (Form 720) or any claim for credit or refund (Form 843) on behalf of the partner.

(4) *Partnership does not represent partner in proceedings.* Unless otherwise agreed upon between the partner and the partnership, the partnership shall not represent the partner in administrative or judicial proceedings to determine the proper treatment of partnership items with respect to the windfall profit tax.

(d) *Partnership responsibilities in event 5-percent election is made.* If the partnership elects to act on behalf of the partners in accordance with §61.6232(c)-2 but a 5-percent election is made to negate that authority, the partnership shall furnish a Form 6248 with respect to each partner in the partnership to the Service and to the partner by the time prescribed in §51.4997-2. The Forms 6248 furnished to the Service shall be filed with the service center designated on that form. The partnership is not permitted to make any adjustment under paragraph (b)(4)(i) of this section with respect to the partners under these circumstances.

(e) *Address of Austin Service Center.* The address of the Austin Service Center to be used for purposes of this section and §§51.6232(c)-2 through 51.6232(c)-5 is: Internal Revenue Service Center, WPT Staff, P.O. Box 934, Austin, Texas 78767, Stop 4002.

§51.6232(c)-2 Election of act on behalf of partners for a removal year after 1984.

(a) *In general.* The partnership may elect to be treated as authorized to act for its partners for a removal year after 1984 by furnishing to the Service the notice described in paragraph (b) of this section. This election is an annual election. The partnership must furnish a separate notice for each removal year for which the partnership wishes to make this selection. For rules with respect to removal years 1983 and 1984, see §150.6232(c)-2.

(b) *Notice to the Service*—(2) *Content of notice.* The partnership shall furnish to the Internal Revenue Service a notice that identifies the partnership by name, address, and taxpayer identification number and is signed by the tax matters partner. The notice shall state that the partnership intends to:

(i) Act on behalf of all partners in any judicial or administrative proceeding with respect to partnership items for windfall profit tax purposes for a removal year;

(ii) Pay on behalf of the partners any additional windfall profit tax determined to be due to reflect the proper treatment of partnership items for that removal year.

(iii) Receive on behalf of the partners any refund of any overpayment of windfall profit tax attributable to partnership items for that removal year; and

(iv) Reimburse the Service upon request for any duplicate refund made to a partner.

(2) *Time and place for filing.* The notice shall be filed with the Austin Service Center (at the address specified in §51.6232(c)-1(e)) on or before September 30 of the removal year to which the election applies (on or before October 31, 1985, for removal year 1985).

(c) *Notice to the partners*—(1) *In general.* A partnership that makes an election by filing a notice under paragraph (b) of this section shall furnish to each of its partners by September 30 of the removal year to which the notice relates (or or before October 31, 1985, for removal year 1985) a notice that includes the information contained in the notice under paragraph (b) of this section.

(2) *Furnish information required.* The notice sent to the partners shall also—

(i) explain the right of any partner or any group of partners holding a 5-percent or greater interest in the income of the partnership to negate the authority of the partnership to act on behalf of all partners by filing a notice in accordance with §51.6232(c)-3; and

(ii) Explain the right of each partner individually to elect not to have the partnership act on behalf of that partner by filing a notice in accordance with §51.6232(c)-4.

§51.6232(c)-3 "5 percent" election for removal years after 1984.

(a) *In general.* Any partner or group of partners owning in the aggregate at least 5 percent of the income interest of the partnership may elect to negate the authority of the partnership to act on behalf of the partners for a removal year after 1984 by filing a written notice to that effect. For rules with respect to removal years 1983 and 1984, see §150.6232(c)-3.

(b) *Procedure for making election*—(1) *Time and place for filing.* The notice described in paragraph (a) of this section shall be filed with the Austin Service Center (at the address specified in §51.6232(c)-1(e)) on or before December 31 of the removal year to which the election applies.

(2) *Content of notice.* The notice shall—

(i) Identify the partnership by name, address, and identification number;

(ii) Identify the partners forming the 5-percent group by name, address, identification number, and percentage interest in the partnership;

(iii) Be signed by all members of the group making the election; and

(iv) Be clearly identified as an election to negate the authority of the partnership to act for all partners.

Any notice not clearly identified as a notice of election under this section shall be treated as an individual election under §51.6232(c)-4. Thus, for example, a notice by a single partner owning a 5-percent interest that is not clearly identified as an election to negate the authority of the partnership to act for all partners shall be treated as an individual election under §51.6232(c)-4.

(3) *copy for partnership.* A copy of the notice shall be furnished to the partnership within the period prescribed for filing the notice.

§51.6232(c)-4 Individual election for a removal year after 1984.

(a) *In general.* Any partner desiring that the partnership not be authorized to act on its behalf for a removal year after 1984 shall file a notice in accordance with the rules set forth in this section. For rules with respect to removal years 1983 and 1984, see §150.6232(c)-4.

(b) *Procedure for making elec-*

tion—(1) *Time and place for filing.* The notice described in paragraph (a) of this section shall be filed with the Austin Service Center (at the address specified in §150.6232(c)-1(e)) on or before December 31 of the removal year to which the election applies.

(2) *Content of notice.* The notice shall clearly identify the partner and the partnership by name, address, and identification number and shall state that it constitutes an election to deny the partnership the right to represent the partner in proceedings related to windfall profit tax on partnership production during the removal year. The notice shall be signed by the partner.

(3) *Copy for partnership.* A copy of the notice shall be furnished to the partnership within the period prescribed for filing the notice.

§51.6232(c)-5 Partner responsibility when partnership authority is negated for removal year after 1984.

(a) *In general.* If the partnership makes an election under §51.6232(c)-2 to act on behalf of the partners for a removal year after 1984, this section shall apply with respect to—

(1) All partners if an election under §51.6232(c)-3 is made, and

(2) Any partner who makes an election under §51.6232(c)-4.

For rules with respect to removal years 1983 and 1984, see §150.6232(c)-5.

(b) *Partner shall pay additional tax or claim credit or refund.* The partner shall aggregate the Form 6248 information received from the partnership with Form 6248 information received from other sources to determine whether a net overpayment or underpayment of windfall profit tax exists for the partner's interests in oil properties. If a net underpayment exists, the partner shall file Form 720 with the service center designated on that form and pay any tax due by the time prescribed in §51.6076-1. If a net overpayment exists, the partner may file a form 843 or any other appropriate form to claim a credit or refund in accordance with the applicable instructions.

(c) *Partner is in same position as under rules for income tax proceedings.* The partner retains any right with respect to the determination of the tax treatment of partnership items for windfall profit tax purposes that the partner would possess under sections 6221 through 6231 and the regulations under those sections. For example, the partner is entitled to receive notice of the proceedings from the tax matters partner or the Service if that partner is entitled to receive notice under section 6223 of the Code, and the partner is entitled to participate in any administrative or judicial proceeding.

Similarly, a settlement agreement entered into between the Service and the tax matters partner is binding on that partner if a settlement entered into under section 6224(c) of the Code would be binding on the partner.

Par. 3. The authority citation for Part 602 continues to read:

Authority: 26 U.S.C. 7805.

Par. 4. Section 602.101(c) is amended by inserting in the appropriate place in the table "51.6232.... 1545-0224."

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved September 17, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of Treasury.

(Filed by the Office of the Federal Register on September 27, 1985, 12:57 p.m., and published in the issue of the Federal Register for October 1, 1985, 50 F.R. 39998)

Chapter 64.—Collection
Subchapter A.—General Provisions

Section 6302.—Mode or Time of Collection

26 CFR 48.6302(c)-1: Use of Government depositories.

Deposits of excise taxes with a Federal Reserve Bank or authorized financial institution. See T.D. 8043, page 214.

Subchapter C.—Lien for Taxes

Section 6323.—Validity and Priority Against Certain Persons

26 CFR 301.6323(f)-1: Place for filing notice; form.

Federal tax lien; filing in Massachusetts. Due to a change in Massachusetts State law, the Service will continue to follow Rev. Rul. 77-61 and file notices of federal tax liens with respect to personal property in Massachusetts only in the office of the United States district court for the judicial district in which the taxpayer resides. Rev. Rul. 84-148 revoked.

Rev. Rul. 85-89

Rev. Rul. 84-148, 1984-2 C.B. 303 holds that notices of federal tax liens with respect to personal property in Massachusetts shall be filed in the office of the State Secretary or, in the case of persons other than estates, trusts, and corporations and partnerships having a principal executive office in Massachusetts, in the office of the clerk of the city or town where the person against whose interest the lien applies resides at the time of filing of the notice of the lien. In so holding, Rev. Rul. 84-148 had modified Rev. Rul. 77-61, 1977-1 C.B. 388. Section 6323(f) of the Internal Revenue Code provides that if a state does not designate "one office" for the filing of notices of federal tax liens, the notice shall be filed with the clerk of the United States district court for the judicial district in which the property subject to the lien is situated. Rev. Rul. 84-148 was based on a July 13, 1983 amendment to Massachusetts state law that was to be effective January 1, 1984. The amendment designated one such office in accordance with section 6323(f) of the Code. *See* 1983 Mass. Acts ch. 278, sec. 5. However, the amendment on which Rev. Rul. 84-148 was predicated was repealed effective December 21, 1983. *See 1983 Mass. Acts ch. 674, repealing* Mass. Ann. Laws ch. 255, sec. 39B (Michie/Law. Co-op Supp. 1984).

The Internal Revenue Service, therefore, will continue to follow Rev. Rul. 77-61 and file notices of federal tax liens with respect to personal property in Massachusetts only in the office of the United States district court for the judicial district in which the taxpayer resides. Pursuant to section 6323(f)(2) of the Code, this is the district where the personal property is deemed located. If state law is again amended to comply with section 6323(f), such liens will be filed only in the one office designated by state law.

Rev. Rul. 84-148 is revoked.

Rev. Rul. 77-61 discusses an additional requirement. The Service had to record the notices of federal tax liens in

a public index at the district office of the Service for the district in which the property subject to the lien is situated. Rev. Rul. 84-148 stated, however, that the recording requirement was repealed with respect to personal property (effective after November 6, 1978) by the Revenue Act of 1978, section 702(q)(1), 1978-3 (Vol. 1) C.B. 1, 171. To this extent Rev. Rul. 77-61 remains modified.

Subchapter D.—Seizure of Property for Collection of Taxes

Section 6331.—Levy and Distraint

26 CFR 301.6331-1(a): Authority to levy. (Also Section 6332; 301.6332-1.)

Ct. D. 2031

SUPREME COURT
OF THE
UNITED STATES
No. 84-498

United States v.
National Bank of Commerce
[472 U.S.]

On Writ of Certiorari
to the United
States Court of Appeals
for the Eighth Circuit

[June 26, 1985]

Syllabus

Section 6331(a) of the Internal Revenue Code of 1954 provides that the Government may collect taxes of a delinquent taxpayer "by levy upon all property and rights to property . . . belonging to such person." Section 6332(a) then provides that "any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary [of the Treasury], surrender such property or rights . . . to the Secretary, except such part of the property or rights as is . . . subject to an attachment or execution." The Internal Revenue Service (IRS) levied on two joint accounts in respondent bank in Arkansas for delinquent income taxes owed by only one of the persons in whose names the accounts stood. When respondent, contending that it did not know how much of the money or deposit belonged to the delinquent taxpayer as opposed to his codepositors, refused to comply with the levy, the United States brought an action in Federal District Court, seeking judgment against respondent for the amount of the delinquent taxes. The District Court granted respondent's motion to dismiss. The Court of Appeals affirmed, holding that because under Arkansas garnishment law a creditor of a bank depositor is not subrogated to the depositor's power to withdraw the account, the IRS, too, could not stand in the depositor's shoes, and that the Government could not make use of the administrative procedure without negating or quantifying the claims that the delinquent taxpayer's codepositors might have to the funds in question. The court reasoned that the delinquent taxpayer did not possess a sufficient property interest in the funds to support the levy, that the codepositors might possess competing claims to the funds, and that an IRS levy is not normally intended for use against property in which third parties have an interest or which bears on its face the names of third parties.

Held: The IRS had a right to levy on the joint accounts in question.

(a) A bank served with an IRS notice of levy has only two defenses for failure to comply with the demand: that it is neither "in possession of" nor "obligated with respect to" property or rights to property belonging to the delinquent taxpayer, or that the taxpayer's property is "subject to a prior judicial attachment or execution." Here, the latter defense was not available, and so respondent's only defense was that the joint accounts did not constitute "property or rights to property" of the delinquent taxpayer.

(b) In applying the Internal Revenue Code, state law controls in determining the nature of the legal interest which the taxpayer has in property. In this case, the delinquent taxpayer had an absolute right under state law to withdraw from the joint accounts, and such state-law right constitutes "property [or] rights to property" belonging to him within the meaning of §6331(a). Respondent, in its turn, was "obligated with respect to" the taxpayer's right to that property under §6332(a), since state law required it to honor any withdrawal request he might make. Respondent thus had no basis for refusing to honor the levy. In a levy proceeding, the IRS acquires whatever right the taxpayer himself possesses.

(c) The question whether a state-law right constitutes "property" or "right to property" is a matter of federal law. Thus, the facts that under Arkansas law the delinquent taxpayer's creditors could not exercise his right to withdrawal in their favor, and in a garnishment proceeding would have to join his codepositors, are irrelevant. That other parties may have competing claims to the account is not a legitimate statutory defense to the levy. A §6331(a) administrative levy is only a *provisional* remedy, which does not determine the rights of third parties until *after* the levy is made, in postseizure administrative or judicial hearings.
726 F.2d 1292, reversed.

BLACKMUN, J., delivered the opinion of the Court, in which BURGER, C.J., and WHITE, RENQUIST, and O'CONNOR, JJ., joined. POWELL, J., filed a dissenting opinion, in which BRENNAN, MARSHALL, and STEVENS, JJ., joined.

JUSTICE BLACKMUN delivered the opinion to the Court.

Section 5331(a) of the Internal Revenue Code of 1954, as amended, 26 U.S.C. §6331(a), provides that the Government may collect taxes of a delinquent taxpayer "by levy upon all property and rights to property . . . belonging to such person."[1] Section 6332(a) of the Code, 26 U.S.C. §6332(a), then provides that "any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary, surrender such property or rights . . . to the Secretary."[2]

[1]Section 6331(a) reads in pertinent part:
"If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary to collect such tax . . . by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person. . . ."
Section 7701(a)(11)(B) of the Code reads:
"The term 'Secretary' means the Secretary of the Treasury or his delegate."

[2]Section 6332(a) reads:
"Except as otherwise provided in subsection (b), any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary, surrender such property or rights (or discharge such obligation) to the Secretary, except such part of the

The controversy in this case concerns two joint accounts in a bank in Arkansas.[3] The issue is whether the Internal Revenue Service (IRS) has a right to levy on those accounts for delinquent federal income taxes owed by only one of the persons in whose names the joint accounts stand in order that the IRS may obtain provisional control over the amount in question.

I

A

The relevant facts are stipulated. On December 10, 1979, the IRS assessed against Roy J. Reeves federal income taxes, penalties, and interest for the taxable year 1977 in the total amount of $3,607.45. As a result of payments and credits, the amount owing on the assessment was reduced to $856.61. App. 11.

On June 13, 1980, there were on deposit with respondent National Bank of Commerce, at Pine Bluff, Ark., the sum of $321.66 in a checking account and the sum of $1,241.60 in a savings account, each in the names of "Roy Reeves or Ruby Reeves or Neva R. Reeves." *Id.*, at 11-12.[4] Each of the persons named, Roy Reeves, Ruby Reeves, and Neva R. Reeves, was authorized by contract with the bank to make withdrawals from each of these joint accounts. *Id.*, at 12.

On the same date, that is, on June 13, 1980, a notice of levy was served on the respondent bank pursuant to §6331(d) of the Code, 26 U.S.C. §6331(d), demanding that the bank pay over to the United States all sums the bank owed to Roy J. Reeves up to a total of $1,302.56. Subsequently, there was a Partial Release of Levy for the amount in excess of $856.61. On October 10, a final demand for payment was served on the bank.

The bank, contending that it did not know how much of the money on deposit belonged to Roy as opposed to Ruby and Neva, refused to comply with the levy. *Ibid.* The United States thereupon instituted this action in the United States District Court for the Eastern District of Arkansas, pursuant to §6332(c)(1) of the Code, 26 U.S.C. §6332(c)(1), seeking judgment against the bank in the amount of $856.61.[5]

By way of a supplement to the stipulation of facts, it was agreed that "[n]o further evidence as to the ownership of the monies in the subject bank accounts will be submitted." App. 17. As a consequence, we do not know which of the three codepositors, as a matter of state law, owned the funds in the two accounts, or in what proportion. The facts thus come to us in very bare form. We are not confronted with any dispute as to who owns what share of the accounts. We deal simply with two joint accounts in the names of three persons, with each of the three entitled to draw out all the money in each of the accounts.

B

The case was submitted to the District Court on cross motions for summary judgment and on the respondent bank's motion to dismiss the complaint. *Id.*, at 18-24. The District Court granted the motion to dismiss, holding the case procedurally "immature." 554 F. Supp. 110, 117 (1982). The court concluded that due process mandates "something more than the post-seizure lawsuit allowed" by the Code's levy procedures. *Id.*, at 114. In its view, "the minimum due process required in distraint actions against joint bank accounts," *ibid.*, compelled the IRS to identify the codepositors of the delinquent taxpayer and to provide them with notice and an opportunity to be heard. *Id.*, at 114-115. The court then outlined the procedures it believed the Constitution requires the IRS to follow when levying on a joint account. Specifically, it ruled that a bank, upon receiving a notice of levy, shoul freeze the assets in the account and pr vide the IRS with the names of th codepositors. *Id.*, at 114. The IRS the should notify the codepositors and giv them a reasonable time "in which to r spond both to the government and the bank by affidavit or other appropr ate means, specifically setting out an ownership interest in the joint accou which they claim and the factual an legal basis for that claim." *Id.*, at 11 If the bank, on the basis of such info mation, "believes that a genuine di pute exists as to the legality of an ownership claim made by" th codepositors, "it may refuse to surre der any portion of the funds s claimed." *Id.*, at 116. At that poin "the government may bring suit to e force the levy on the contested funds, *ibid.*, but it must name the codepositor as defendant along with the bank.

The United States Court of Appea for the Eighth Circuit affirmed, 72 F.2d 1292 (1984). It expressed n opinion on the District Court's constitu tional analysis. *Id.*, at 1293, 1300. reached essentially the same resul however, as a matter of statutory co struction. It ruled that the IRS, whe levying on a joint bank account, has th burden of proving "the actual value the delinquent taxpayer's interest i jointly owned property." *Id.*, at 129 It observed that here "the rights of th various parties," *id.*, at 1300, had n been determined. Therefore, the Gov ernment had not shown the bank to b in possession of property or rights t property belonging to the delinquen taxpayer, Roy J. Reeves, as §6331(a required.

The Court of Appeals acknowledge that "Roy could have withdrawn an amount he wished from the account and used it to pay his debts, includin federal income taxes. . . ." *Id.*, at 129 It rejected, however, the Government' contention that it stood "in Roy's shoe and could do anything Roy could do subject to whatever duties Roy owes t Ruby or Neva," *id.*, at 1295-1296, fo it observed that "at least as to ordinar creditors, [that] is not the law o Arkansas." *Id.*, at 1296. Under stat garnishment law, the court noted, creditor of a codepositor is not "subro gated to that co-owner's power to with draw the entire account." Instead,

[3] "The basic legal concept of 'joint account' means that it be in two or more names." *Harbour v. Harbour*, 207 Ark. 551, 555, 181 S.W.2d 805, 807 (1944).

[4] No point is made as to any distinction between the "Roy J. Reeves" against whom the assessment was made, and the "Roy Reeves" whose name was on the two accounts. We assume, accordingly, that Roy J. Reeves and Roy Reeves are one and the same person.

The record does not disclose any relationship that may exist among the three codepositors. The parties have indicated that Neva is Roy's wife and that Ruby is his mother.

[5] The complaint also asserted liability, under §6332(c)(2), for a 50% penalty. See App. 7. The Government, however, subsequently waived the penalty claim, and the complaint was amended accordingly. *Id.*, at 13-15.

creditor must join both co-owners as defendants and permit them to "show by parol or otherwise the extent of his or her interest in the account." *Ibid.*

The Court of Appeals then concluded that a similar precept should apply in administrative levy proceedings under the Internal Revenue Code. It accordingly ruled that the Government could not prevail without negating or quantifying the claims that Ruby or Neva might have to the funds in question. It expressed the belief that an IRS administrative levy "is not normally intended for use as against property in which third parties have an interest" or as "against property bearing on its face the names of third parties." *Id.*, at 1300. In such a situation, the Government was free to "brin[g] suit to foreclose its lien under Section 7403," joining the codepositors or defendants. *Ibid.*

Because the opinion of the Court of Appeals appeared to us to conflict, directly or in principle, with decisions of other Courts of Appeals,[6] we granted certiorari. ___ U.S. ___ (1985).

II

A

Section 6321 of the Code, 26 U.S.C. §6321, provides: "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount . . . shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." Under the succeeding §6322, the lien generally arises when an assessment is made, and it continues until the taxpayer's liability "is satisfied or becomes unenforceable by reason of lapse of time."

The statutory language "all property and rights to property," appearing in §6321 (and, as well, in §§6331(a) and 6332(a), see nn. 1 and 2, *supra*), is broad and reveals on its face that Congress meant to reach every interest in property that a taxpayer might have. See 4 B. Bittker, Federal Taxation of Income, Estates and Gifts ¶111.5.4, p. 111-100 (1981) (Bittker). "Stronger language could hardly have been selected to reveal a purpose to assure the collection of taxes." *Glass City Bank* v. *United States*, 326 U.S. 265, 267 (1945).

A federal tax lien, however, is not self-executing. Affirmative action by the IRS is required to enforce collection of the unpaid taxes. The Internal Revenue Code provides two principal tools for that purpose. The first is the lien-foreclosure suit. Section 7403(a) authorizes the institution of a civil action in federal district court to enforce a lien "to subject any property, of whatever nature, of the delinquent, or in which he has any right, title, or interest, to the payment of such tax." Section 7403(b) provides: "All persons have liens upon or claiming any interest in the property involved in such action shall be made parties thereto." The suit is a plenary action in which the court "shall . . . adjudicate all matters involved therein and finally determine the merits of all claims to and liens upon the property." §7403(c). See generally *United States* v. *Rodgers*, 461 U.S. 677, 680-682 (1983) [1983-2 C.B. 253]. The second tool is the collection of the unpaid tax by administrative levy. The levy is a provisional remedy and typically "does not require any judicial intervention." *Id.*, at 682. The governing statute is §6331(a). See n.1, *supra*. It authorizes collection of the tax by levy which, by §6331(b), "includes the power of distraint and seizure by any means."

In the situation where a taxpayer's property is held by another, a notice of levy upon the custodian is customarily served pursuant to §6332(a). This notice gives the IRS the right to all property levied upon, *United States* v. *Eiland*, 223 F.2d 118, 121 (CA4 1955), and creates a custodial relationship between the person holding the property and the IRS so that the property comes into the constructive possession of the Government. *Phelps* v. *United States*, 421 U.S. 330, 334 (1975) [1975-1 C.B. 372]. If the custodian honors the levy, he is "discharged from any obligation or liability to the delinquent taxpayer with respect to such property or rights to property arising from such surrender or payment." §6332(d). If, on the other hand, the custodian refuses to honor a levy, he incurs liability to the Government for his refusal. §6332(c)(1).

The administrative levy has been aptly described as a "provisional remedy." 4 Bittker, at ¶111.5.5, p. 111-108. In contrast to the lien-foreclosure suit, the levy does not determine whether the Government's rights to the seized property are superior to those of other claimants; it, however, does protect the Government against diversion or loss while such claims are being resolved. "The underlying principle" justifying the administrative levy is "the need of the government promptly to secure its revenues." *Phillips* v. *Commissoner*, 283 U.S. 589, 596 (1931). "Indeed, one may readily acknowledge that the existence of the levy power is an essential part of our self-assessment tax system," for it "enhances voluntary compliance in the collection of taxes." *G.M. Leasing Corp.* v. *United States*, 429 U.S. 338, 350 (1977) [1977-1 C.B. 389, 393]. "Among the advantages of administrative levy is that it is quick and relatively inexpensive." *united States* v. *Rodgers*, 461 U.S., at 699 [1983-2 C.B. 253, 260].

The constitutionality of the levy procedure, of course, "has long been settled." *Phillips* v. *Commissioner*, 283 U.S., at 595. See *G.M. Leasing Corp.* v. *United States*, 429 U.S., at 352, n.18.

B

It is well established that a bank account is a species of property "subject to levy," within the meaning of §§6331 and 6332. A levy on a bank account has been permitted since the Revenue Act of 1924, §1016, 43 Stat. 343, and the Treasury Regulations explicitly authorize such levies. Treas. Reg. §301.6331-1(a)(1), 26 CFR §301.6331-1(a)(1) (1984).

The courts uniformly have held that a bank served with an IRS notice of levy "has only two defenses for a failure to comply with the demand." *United States* v. *Sterling National Bank & Trust Co. of New York*, 494 F.2d 919, 931 (CA2 1974), and cases cited. One defense is that the bank, in the words of §6332(a), is neither "in pos-

[6] See, *e.g.*, *United States* v. *Sterling National Bank & Trust Co. of New York*, 494 F.2d 919, 922 (CA2 1974); *United States* v. *Citizens & Southern National Bank*, 538 F.2d 1101, 1105-1107 (CA5 1976), cert. denied, 430 U.S. 945 (1977); *Babb* v. *Schmidt*, 496 F.2d 957, 958-960 (CA9 1974); *Bank of Nevada* v. *United States*, 251 F.2d 820, 824-826 (CA9 1957), cert. denied, 356 U.S. 938 (1958). See also Rev. Rul. 79-38, 1979-1 Cum. Bull. 406, 407.

session of" nor "obligated with respect to" property or rights to property belonging to the delinquent taxpayer. The other defense, again with reference of §6332(a), is that the taxpayer's property is "subject to a prior judicial attachment or execution." 494 F.2d, at 921. Accord, *Bank of Nevada* v. *United States*, 251 F.2d 820, 824 (CA9 1957), cert. denied, 356 U.S. 938 (1958).

There is no suggestion here that the Reeves accounts were subject to a prior judicial attachment or execution. Nor is there any doubt that the bank was "obligated with respect to" the accounts because, as it concedes, "Roy Reeves did have a right under Arkansas law to make withdrawals from the bank accounts in question." Brief for Respondent 2. The bank's only defense, therefore, is that the joint accounts did not constitute "property or rights to property" of Roy J. Reeves. See §6331(a).

C

"'[I]n the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property.'" *Aquilino* v. *United States*, 363 U.S. 509, 513 (1960) [1960-2 C.B. 477, 479], quoting *Morgan* v. *Commissioner*, 309 U.S. 78, 82 (1940). See also *Sterling National Bank*, 494 F.2d, at 921. This follows from the fact that the federal statute "creates no property rights but merely attaches consequences, federally defined, to rights created under state law." *United States* v. *Bess*, 357 U.S. 51, 55 (1958) [1958-2 C.B. 934, 935]. And those consequences are "a matter left to federal law." *United States* v. *Rodgers*, 461 U.S., at 683 [1983–2 C.B. 253, 255]. "[O]nce it has been determined that state law creates sufficient interests in the [taxpayer] to satisfy the requirements of [the statute], state law is inoperative," and the tax consequences thenceforth are dictated by federal law. *United States* v. *Bess*, 357 U.S., at 56-57 [1958-2 C.B. 934, 936]. See also *Fidelity & Deposit Co. of Maryland* v. *New York City Housing Authority*, 241 F.2d 142, 144 (CA2 1957); Note, Property Subject to the Federal Tax Lien, 77 Harv. L. Rev. 1485, 1486-1487 (1964).

In the *Bess* case, the Court held that a delinquent taxpayer, who had purchased life insurance policies, did not have "property or rights to property" in the death proceeds of the policies, but that he did have such rights in their cash surrender value. 357 U.S., at 55-56. The latter conclusion, it was said, followed from the fact that the taxpayer insured had "the right under the policy contract to compel the insurer to pay him this sum." *Id.*, at 56. Thus, the insured's interest in the cash surrender value was subject to the federal tax lien. The fact that "under State law the insured's property right represented by the cash surrender value is not subject to creditors' liens" was irrelevant. *Id.*, at 56-57. State law defined the nature of the taxpayer's interest in the property, but the state law consequences of that definition are of no concern to the operation of the federal tax law.

As noted above, it is stipulated that Roy J. Reeves had the unqualified right to withdraw the full amounts on deposit in the joint accounts without notice to his codepositors. In any event, wholly apart from the stipulation, Roy's right of withdrawal is secured by his contract with the bank, as well as by the relevant Arkansas statutory provisions. See Ark. Stat. Ann. §§67-521 and 67-552 (1980).[7] On its part, the bank was obligated to honor any withdrawal requests Roy might make, even up to the full amounts of the accounts. The Court of Appeals thus correctly concluded that, under Arkansas law, "Roy could have withdrawn any amount he wished from the account and used it to pay his debts, including federal income taxes, and his co-owners would have had no lawful complaint against the bank." 726 F.2d, at 1295.

Roy, then, had the absolute right under state law and under his contract with the bank to compel the payment of the outstanding balances in the two accounts. This, it seems to us, should have been an end to the case, for we agree with the Government that such a state-law right constituted "property [or] rights to property . . . belonging to" Roy, within the meaning of §6331(a).

[7]Effective March 25, 1983, after the issuance of the notice of levy here, §67-552 was amended and §67-521 was repealed. 1983 Ark. Gen. Acts, No. 843, §§1 and 2. The result was recodification without substantial change.

The bank, in its turn, was "obliga
with respect to" Roy's right to t
property, §6332(a), since state law
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quest he might make. The bank had
basis for refusing to honor the levy

The overwhelming majority of co
that have considered the issue has h
that a delinquent taxpayer's restric
right to withdraw constitutes "proper
or "rights to property" subject to pr
sional IRS levy, regardless of the fa
that other claims to the funds may e
and that the question of ultimate own
ship may be unresolved at the tir
See, *e.g.*, *United States* v. *Sterling*
tional Bank & Trust Co. of New Yo
494 F.2d, at 921-922; *United States*
Citizens & Southern National Ba
538 F.2d 1101, 1105-1107 (C
1976), cert. denied, 430 U.S. 9
(1977); *Citizens & Peoples Natio*
Bank of Pensacola, Fla. v. *Uni*
States, 570 F.2d 1279, 1282-12
(CA5 1978); *Babb* v. *Schmidt*, 4
F.2d 957, 958-960 (CA9 1974); *B*
of Nevada v. *United States*, 251 F.
at 824-826; *United States* v. *First*
tional Bank of Arizona, 348 F. Su
388, 389 (Ariz. 1970), aff'd, 458 F
513 (CA9 1972); *United States* v.

*The dissent misunderstands the impor
United States v. *Bess*, 357 U.S. 51, 55 (19
See *post*, at 9-16. Because state law gives the
linquent the right to withdraw, but puts cer
limits on the rights of creditors, and attaches
tain consequences to that right as regards the
linquent himself, the dissent asserts that the G
ernment is limited by these same state-
constraints. Thus it urges that the Governme
right here is no greater than the rights given
der state law, the right to withdraw and noth
else. It therefore erroneously characterizes
Government's authority here as limited to
right to levy on the right to withdraw, and n
ing else. See *post*, at 9-13 and nn.9 and 10.
under *Bess*, state law controls only in deter
ing the nature of the legal interest which the
payer has in the property. See also *Aquilin*
United States, 363 U.S. 509, 513 (1960). On
is determined that under state law the delinq
has the right to withdraw property in a joint
account, it is a matter of *federal* law what co
quences attach to this right. And we agree
the Government that as a matter of federal
the state-law right to withdraw money fro
joint bank account is a "right to property"
quate to justify the use of the provisional
procedure of §6331. The dissent's reference
state cases concerning the state-law implicat
of the right to withdraw, see *post*, at 9, thus
entirely irrelevant, for such state law is "inop
tive" in determining the federal tax conseque
of the delinquent's right to withdraw. See *B*
357 U.S. at 56-57.

uitable Trust Co., 49 AFTR2d ¶82-428 (Md. 1982); *Sebel* v. *Lytton Savings & Loan Ass'n*, 65-1 USTC ¶9343 (SD Cal. 1965); *Tyson* v. *United States*, 63-1 USTC ¶9300 (Mass. 1962); *United States* v. *Third Nat. Bank & Trust Co.*, 111 F. Supp. 152, 155-156 (MD Pa. 1953). And the Eighth Circuit itself has observed that the "unqualified contractual right to receive property is itself a property right subject to seizure by levy." *St. Louis Union Trust Co.* v. *United States*, 617 F.2d 1293, 1302 (1980).[9]

Common sense dictates that a right to withdraw qualifies as a right to property for purposes of §§6331 and 6332. In a levy proceeding, the IRS " 'steps into the taxpayer's shoes,' " *United States* v. *Rodgers*, 461 U.S., at 691, n.16, quoting 4 Bittker, at ¶111.5.4, p. 111-102; M. Saltzman, IRS Practice and Procedure ¶14.08, p.14-32 (1981); Brief for Respondent 8. The IRS acquires whatever rights the taxpayer himself possesses. And in such circumstances, where, under state law, a taxpayer has the unrestricted right to withdraw funds from the account, "it is inconceivable that Congress . . . intended to prohibit the Government from levying on that which is plainly accessible to the delinquent taxpayer-depositor." *United States* v. *First National Bank of Arizona*, 348 F. Supp., at 389. Accord, *United States* v. *Citizens & Southern National Bank*, 538 F.2d, at 1107.[10] The taxpayer's right to withdraw is analogous in this sense to the IRS' right to levy on the property and secure the funds. Both actions are similarly provisional and subject to a later claim by a codepositor that the money in fact belongs to him or her.

[9]The dissent's suggestion that these cases are "irrelevant," see *post*, at 12-13, n.9, stems from its erroneous assumption that state law dictates the extent of the Government's power to levy. It does not, and these cases all stand for the proposition that a delinquent's state-law right to withdraw funds from the joint bank account is a property interest sufficient for purposes of federal law for the Government to levy the account, notwithstanding the fact that questions as to the ultimate ownership of the funds may be unresolved.

[10]We stress the narrow nature of our holding. By finding that the right to withdraw funds from a joint bank account is a right to property subject to administrative levy under §6331, we express no opinion concerning the federal characterization of other kinds of state-law created forms of joint ownership. This case concerns the right to levy only upon joint bank accounts.

III

The Court of Appeals, however, applied state law beyond the point of that law's specification of the nature of the property right, and bound the IRS to certain consequences of state property law. Because under Arkansas garnishment law, a creditor of a depositor is not subrogated to the depositor's power to withdraw the account, the court reasoned that the IRS, too, could not stand in the depositor's shoes. This gloss, it seems to us, is contrary to the analysis and holding in *United States* v. *Bess*, *supra*. The Court of Appeals adduced three principal justifications for its result. The first was its belief that under Arkansas law Roy did not have a sufficient property interest in the funds to support the levy. The second was its concern that Ruby and Neva might possess competing claims to the funds on deposit, and that the bank might be subject to claims asserted by them. The third was its stated conclusion that "levy is not normally intended for use as against property . . . bearing on its face the names of third parties, and in which those third parties likely have a property interest." 726 F.2d, at 1300.

We are not persuaded by any of these asserted jusifications.

The Court of Appeals' conclusion that Roy did not possess "property [or] rights to property" on which the IRS could levy rested heavily on its understanding of the Arkansas law of creditors' rights, particularly those in garnishment. *Id.*, at 1295-1296. See *Hayden* v. *Gardner*, 238 Ark. 351, 381 S.W.2d 752 (1964). As we have suggested, this misconceives the role properly played by state law in federal tax-collection matters. The question whether a state-law right constitutes "property" or "rights to property" is a matter of federal law. *United State* v. *Bess*, 357 U.S., at 56-57. Thus, the facts that under Arkansas law Roy's creditors, unlike Roy himself, could not exercise his right to withdrawal in their favor and in a garnishment proceeding would have to join his codepositors are irrelevant. The federal statute relates to the taxpayer's rights to property and not to his creditor's rights. The Court of Appeals would remit the IRS to the rights only an ordinary creditor would have under state law. That result "compare[s] the government to a class of creditors to which it is superior." *Randall* v. *H. Nasahima & Co.*, 542 F.2d 270, 274, n.8 (CA5 1976).

The Court of Appeals also has concerned that Ruby and Neva might have rights that are affected if the levy were honored. 726 F.2d, at 1297-1300. This reasoning, however, runs counter to the observation above that a bank served with a notice of levy has two, and only two, possible defenses for failure to comply with the demand: that it is not in possession of property of the taxpayer, or that the property is subject to a prior judicial attachment or execution. As we have stated, neither defense is applicable here. That another party or parties have competing claims to the accounts is not a legitimate statutory defense.

In its understandable concern for Ruby's and Neva's property interests, the Court of Appeals has ignored the statutory scheme established by Congress to protect those rights. Crucially, the administrative levy, as has been noted, is only a provisional remedy. "The final judgment in [a levy] action settles no rights in the property subject to seizure." *United States* v. *New England Merchants National Bank*, 465 F. Supp. 83, 87. (Mass. 1979). Other claimants, if they have rights, may assert them. Congress recognized this when the Code's summary-collection procedures were enacted. S. Rep. No. 1708, 89th Cong., 2nd Sess., 29 (1966), and when it provided in §7426 of the Code, 26 U.S.C. §7426, that one claiming an interest in property seized for another's taxes may bring a civil action against the United States to have the property or the proceeds of its sale returned.[11] Congress also has pro-

[11]The dissent would find support in *United States* v. *Stock Yards Bank of Louisville*, 231 F.2d 628 (CA6 1956), and *Raffaele* v. *Granger*, 196 F.2d 620 (CA3 1952). See *post*, at 11, n.8. Both cases are clearly distinguishable. *Stock Yards Bank* concerned an attempted levy upon United States Savings Bonds, held in the names of husband and wife, to satisfy the husband's tax liability. Savings bonds, however, are different from joint bank accounts and possess "limitations and conditions . . . which are delineated by the terms of the contract by federal law." 231 F.2d, at 630. Furthermore, the case was decided prior to the enactment of §7426, which was added to the Internal Revenue Code by the Federal Tax Lien Act of 1966, §110(a), 80 Stat. 1142 [Pub. L. 89-719, 1966-2 C.B. 623, 638].

vided, by §6343(b), an effective and inexpensive administrative remedy for the return of the property. See Treas. Reg. §301.6343-1(b)(2), 26 CFR §301.6343-1(b)(2) (1984).[12]

Congress thus balanced the interest of the Government in the speedy collection of taxes against the interests of any claimants to the property, and reconciled those interests by permitting the IRS to levy on the assets at once, leaving ownership disputes to be resolved in a post-seizure administrative or judicial proceeding. See *United Sand & Gravel Contractors, Inc.* v. *United States*, 624 F.2d 733, 739 (CA5 1980); *Valley Finance Inc.* v. *United States*, 203 U.S. App. D.C. 128, 136-137, 629 F.2d 162, 170-171 (1980), cert. denied, 451 U.S. 1018 (1981). Its decision that certain property rights must yield provisionally to governmental need should not have been disregarded by the Court of Appeals. Nor would the bank be exposed to double liability, were it to honor the IRS levy. The Code provides administrative and judicial remedies for codepositors against the Government, and any attempt to secure payment in this situation from the bank itself would be contrary to the federal enforcement scheme.[13]

The Court of Appeals' final justification for its holding was its belief that an IRS levy "is not normally intended for use as against property in which third parties have an interest" or "as against property bearing on its face the names of third parties, and in which those third parties likely have a property interest." 726 F.2d, at 1300. The court acknowledged the existence of §7426 but felt that that statute was designed to protect only those third parties "whose property has been seized 'inadvertently.' " 726 F.2d, at 1300.

We disagree. The IRS' understanding of the terms of the Code is entitled to considerable deference. Here, moreover, collection provisions plainly contemplate that a taxpayer's interest in property may be less than full ownership. The tax lien attaches not only to "property" but also to "rights to property."; See S. Rep. No. 1708, at 29 [1966-2 C.B. 876]. Further, we see nothing in the language of §7426 that distinguishes among various species of third-party claimants. The language of the statute encompasses advertent seizures as well as inadvertent ones.[14]

There is nothing express or implied i
United States v. *Rodgers*, *supra*, to th
contrary.

Rodgers held that §7403 empowers
District Court to order the sale of
family house in which a delinquent ta
payer has an interest, even though
nondelinquent spouse also has a hom
stead interest in the house under sta
law. 461 U.S., at 698–700. In so ru
ing, the Court contrasted the operatio
of §7403 with that of §6331. See 4
U.S., at 696. The Court noted th
§6331, unlike §7403, does not "imp
cate the rights of third parties," becau
an administrative levy, unlike a judic
lien-foreclosure action, does not de
mine the ownership rights to the pr
erty. Instead, third parties whose pr
erty is seized in an administrative le
"are entitled to claim that the prope
has been 'wrongfully levied upon,' a
may apply for its return either throu
administrative channels . . . or throu
a civil action." *Id.*, at 696. The Co
in other words, recognized what
now make explicit: that §6331 is a *p*
visional remedy, which does not de
mine the rights of third parties until
ter the levy is made, in postseiz
administrative or judicial hearings.[

Raffaele v. *Granger* is even less on point. The decision there did not concern the property of a provisional remedy, but the final ownership of the property in question. The court held that under Pennsylvania law a husband and wife's joint bank account was held by them together as tenants by the entirety, and that therefore the Government could not use the money in the account to satisfy the tax obligations of one spouse. The fact that either spouse could withdraw the property did not mean that it could be used to satisfy either spouse's tax obligations. 196 F.2d, at 622-623. The Government here does not claim otherwise; it merely asserts the right to levy on such property and have all third-parties who claim to own it come forward and make their claim.

[12]We do not pass upon the constitutional questions that were addressed by the District Court, but not by the Court of Appeals, concerning the adequacy of the notice provided by §6343(b) and §7426 to persons with competing claims to the levied property. There is nothing in the sparse record in this case to indicate whether Ruby and Neva Reeves were on notice as to the levy, or as to what the Government's practice is concerning the notification of codepositors in this context. As the parties are free to address this issue on remand, the dissent's concerns on this score, see *post*, at 15-16, are decidedly premature.

[13]As a result, it may well be that any attempt to recover against the bank under state law would be pre-empted. We need not resolve that question, however, for, under Arkansas law, the bank's payment to one depositor was a complete defense against suit on a codepositor's claim. Ark. Stat. Ann. §§67-521, 67-552(b) (1980). Since the government stood in Roy's shoes when it levied upon the joint account, the bank's payment to the IRS would likewise insulate the bank from actions by Roy's codepositors.

[14]The dissent's central argument apes the decision of the Court of Appeals in suggesting that there is something in the language of §6331 that, when compared to the language of §7403, requires that it be read to apply only to the case where the Government has proof that the property levied upon "*completely* belong[s]" to the delinquent. See *post*, at 9 (emphasis added). The adverb, however, simply is not part of the statutory language. The dissent bases its reading on the contrast between the language in §7403, "property . . . in which [the delinquent] has any right, title, or interest," with the language in §6331, "property and rights to property . . . belonging to the delinquent." See *id.* at 5–9. While the dissent's reading of the statutes in contrast is plausible, so too is the Government's, especially in light of the fact that §6331 refers to "rights to property" as well as "property." The legislative history also supports the agency's understanding of the statutory language. Thus when Congress in §7426 enacted a cause of action for one whose property was wrongfully levied, it explicitly recognized that it was protecting against the situation "where the Government levies on property which, *in part at least*, a third person considers to be his." S. Rep. No. 1708, 89th Cong., 2d Sess., 29 (1966) (emphasis added) [1966-2 C.B. 876, 897]). If Congress intended §6331 to give the Government the power to levy only u
property it knows to be wholly owned by the
linquent, it never would have felt the need t
act §7426. When the agency's plausible inte
tation of its statute is supported by the p
meaning of the statute, the statutory scheme
whole, and the legislative history, we shal
reject it because another plausible reading
statute is possible.

The dissent also is incorrect when it in
that the Court gives the word 'wrongf
strained understanding in finding that a
party's property could be "wrongful[ly]"
even though the Government properly wa
lowing the procedures of §6331. See *post*,
n. 11. The legislative history makes clear th
word 'wrongful' as it is used in §7426(a)
not to intentional wrongdoing on the Go
ment's part, but rather 'refers to a proce
against property which is not the taxpayer'
Rep. No. 1708, at 30 [1966-2 C.B. 876,

[15]The dissent's misreading of *Rodgers* i
piece with its misunderstanding of the G
ment's use of §6331 as a provisional rem
seize property. See *ante*, at 8–11, and n.
reason that §6331 is not itself "punctilious
tecting the vested rights of third parties ca
the Government's collection effort." *Roger*
U.S., at 699, is that the levy does not pur
determine any rights to the property. It
protects the Government's interests so tha
to the property may be determined
postseizure proceeding. It is in those proce
that the rights of any who claim an interes

The Court of Appeals' result would force the IRS, if it wished to pursue a delinquent taxpayer's interest in a joint bank account, to institute a lien-foreclosure suit under §7403, joining all codepositors as defendants. The practical effect of this would be to eliminate the alternative procedure for administrative levy under §§6331 and 6332. We do not lightly discard this alternative relief that Congress so clearly hs provided for the Government. If the IRS were required to bring a lien-foreclosure suit each time it wished to execute a tax lien on funds in a joint bank account, it would be uneconomical, as a practical matter, to do so on small sums of money such as those at issue here. And it would be easy for a delinquent taxpayer to evade, or at least defer, his obligations by placing his funds in joint bank accounts. While one might not be enthusiastic about paying taxes, it is still true that 'taxes are the life-blood of government, and their prompt and certain availability an imperious need." *Bull* v. *United States*, 295 U.S. 247, 259 (1935).

The judgment of the Court of Appeals is reversed.

It is so ordered.

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property are punctiliously protected. In comparing §6331 to §7403 in this manner, the dissent compares apples and oranges. A more telling comparison to the lien-foreclosure proceeding of §7403 would be 'with the administrative and judicial remedies for third parties whose property has been subject to wrongful levy, that is, with §§6343(b) and 7426(a)(1). It was just such a comparison that was made in this context by the Court in *Rodgers*. See 461 U.S., at 696.

Nor is *Mansfield* v. *Excelsior Refining Co.*, 135 U.S. 326 (1890) (which not surprisingly was not relied on by the District Court or the Court of Appeals or by any of the parties here), in any way related to our holding today. That case involved provisions of the 1868 tax code that required a distiller who rented the property upon which it ran its distillery to obtain a "waiver" from the fee holder stipulating that a lien of the United States on the property for taxes owed by the distiller shall have priority over any mortgage held by the person executing the waiver, and giving the Government the rightful title to the property in case of forfeiture. Act of July 20, 1868, ch. 186, §8, 15 Stat. 128. See 135 U.S., at 328–329, 338–339. The Court held that this waiver did not entitle the Government to treat the property as if it belonged to the distiller for purposes of the then tax code's levy provisions. *Id.*, at 338. The waiver, the Court held, did not give the distiller a fee interest in the premises, nor did it give the Government the right to anything more than a first or prior lien. *Id.*, at 339.

That holding is irrelevant to the present controversy. Insofar as the case stands for any general proposition at all concerning the Government's power to levy, it is *not* that a levy cannot be used to freeze assets when the delinquent "had less than a complete interest" in the property levied, see *post*, at 6, but that the government may not levy upon a leasehold interest and then turn around and sell a fee interest—an entirely different kind of interest. In *Mansfield*, the Court held that the delinquent held no interest in the fee that could be levied upon, and so that case has nothing to do with the question whether the Government can levy when the extent of the delinquent's interest in the property is not finally determined. The part of the decision relied upon by the dissent has to do with the nature of the "waiver" as it affects the characterization of the interest held by the renter/distiller in the underlying fee. The phrase cited by the dissent in context stands for the proposition that the waiver did not give the delinquent a fee interest that the Government could levy upon, but rather gave the Government the right to foreclose on its lien through a suit in equity.

Section 6332.—Surrender of Property Subject to Levy

26 CFR 301.6332-1: Surrender of property subject to levy.

Whether a bank must honor a Service levy on joint bank accounts for delinquent taxes owed by only one of the persons in whose names the accounts stand. See Ct. D. 2031, page 327.

Chapter 65.—Abatements, Credits and Refunds
Subchapter A.—Procedures in General

Section 6402.—Authority to Make Credits or Refunds

26 CFR 301.6402-1: Authority to make credits or refunds.

T.D. 8053

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER F, PART 301—PROCEDURE AND ADMINISTRATION

Reduction of Tax Overpayments by Amount of Past-due Legally Enforceable Debt Owed to Federal Agency

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary Regulations; final regulations.

SUMMARY: This document contains temporary regulations and final regulations relating to the reduction of a taxpayer's overpayment (*i.e.*, tax refund) by the amount of any past-due legally enforceable debt owed to a Federal agency and referred by that agency to the Internal Revenue Service for offset. The text of the temporary regulations set forth in this document also serves as the text of the proposed regulations cross-referenced * * * [on page 839, this Bulletin]. Changes to the applicable law were made by the Spending Reduction Act of 1984. The regulations affect any taxpayer who owes a past-due legally enforceable debt to any Federal agency identified as eligible to participate in the tax refund offset program by the Commissioner of Internal Revenue and who has made an overpayment of taxes, and such Federal agency to which the past-due legally enforceable debt is owed.

DATES: The regulations apply to refunds payable under section 6402 of the Internal Revenue Code of 1954 after December 31, 1985 and before January 1, 1988 and are effective upon publication.

FOR FURTHER INFORMATION CONTACT: Sharon L. Hall of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3288 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document amends the Procedure and Administration Regulations (26 CFR Part 301) to provide rules under section 6402(d) and (e) of the Internal Revenue Code of 1954, and section 3720A of subchapter II of chapter 37 of title 31, United States Code. Section 6402(d) and (e) was added to the Internal Revenue Code, and section 3720A was added to title 31 of the United States Code, by section 2653 of the Spending Reduction Act of 1984 (Pub. L. 98-369, 98 Stat. 1153) [1984-3 C.B. (Vol. 1) 1, 661]. The temporary regulations contained in this document will remain in effect until superseded by additional temporary or final regulations published in the FEDERAL REGISTER.

EXPLANATION OF STATUTORY PROVISIONS

Section 6402(d) of the Internal Revenue Code requires the Internal Revenue Service (1) to reduce the amount of any overpayment (*i.e.*, tax refund) otherwise payable to a taxpayer by the amount of any past-due legally enforceable debt owed to a federal agency of which the Service has been notified, (2) to pay the amount of the reduction to the agency to which the debt is owed, and (3) to notify the taxpayer that the overpayment has been reduced. That subsection also provides that before reduction for past-due legally enforceable debt, an overpayment shall be reduced for an outstanding liability for past-due support assigned to a State under section 402(a)(26) or 471(a)(17) of the Social Security Act ,and in case more than one debt is owed by a taxpayer, the reduction of the overpayment shall be applied to the debts in the order in which they accrued.

Section 6402(e) provides that no court of the United States shall have jurisdiction to hear any action brought to restrain or review a reduction of an overpayment for past-due support under 6402(c) or past-due legally enforceable debt under 6402(d), and that no such reduction can be reviewed by the Service in an administrative proceeding.

Section 3720A(a) of title 31 provides that any Federal agency that is owed a past-due legally enforceable debt shall notify the Internal Revenue Service of the amount of the debt. Under section 3720A(b), a Federal agency must, before notifying the Service, notify the taxpayer who is responsible for the debt that the agency plans to refer the taxpayer's debt to the Service for offset of any Federal tax refund; determine that the debt is past-due and legally enforceable after providing the taxpayer at least 60 days in which to present evidence to the contrary; and make reasonable efforts to collect the debt. Section 3720A(c) requires the Service to reduce the tax refund, if any, payable to a taxpayer by the amount of the past-due legally enforceable debt owed to the creditor agency and to pay the amount of the reduction to the agency. Under section 3720A(d), the Service is directed to issue regulations providing the time and manner of submission of notification. Section 3720A(e) requires any Federal agency which has received an erroneous payment from the Service to repay such amount to the Service.

EXPLANATION OF REGULATORY PROVISIONS

The temporary regulations under section 6402(d) and (e) and section 3720A provide that, for purposes of the pilot tax refund offset program, the Commissioner of Internal Revenue will identify those creditor Federal agencies which are eligible to enter into an agreement with the Service with regard to their participation in this offset program. In addition, the regulations provide guidance as to which past-due legally enforceable debts qualify for offset. The regulations include the statutory requirements that prior to referral of a debt to the Service, an agency must give the debtor at least 60 days to present evidence that all or part of the debt is not past-due or legally enforceable, consider any evidence presented, and determine that the debt is past-due and legally enforceable. The regulations also require that debts to be offset after 1986 first must be referred to a consumer reporting agency under 31 U.S.C. 3711(f), which includes a similar 60-day period for notice and administrative review prior to referral to a consumer reporting agency. Agencies will not be required to duplicate such administrative review to the extent they have previously complied with identical requirements under 31 U.S.C. 3711(f).

The regulations set forth requirements relating to time of notification to the Service, the content of the notification, and procedures for correction of notification after submission of the initial information. The regulations describe the disposition of the amounts collected and provide that a fee sufficient to cover the Service's cost of the offset procedure shall be billed to, and collected from, the participating agencies.

The final regulations conform existing regulations under section 6402 to the changes made to 6402(c) and (d) by section 2653 of the Spending Reduction Act of 1984 and section 21 of the Child Support Enforcement Amendments of 1984.

EXECUTIVE ORDER 12291 AND REGULATORY FLEXIBILITY ACT

The Commissioner of Internal Revenue has determined that these temporary and final rules are not major rules as defined in Executive Order 12291 and, therefore, a Regulatory Impact Analysis is not required. A general notice of proposed rulemaking is not required by 5 U.S.C. 553 for temporary regulations or for final regulations subject to 5 U.S.C. 553(b)(3). Accordingly, these temporary and final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of these regulations is Sharon L. Hall of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

* * * * *

Amendments to the regulations

The amendments to 26 CFR Part 301 are as follows:

Paragraph 1. The authority for Part 301 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * Section 301.6402-6T also issued under 31 U.S.C. 3720A.

Par. 2. Section 301.6402-1 is revised to read as follows:

§301.6402-1 Authority to make credits or refunds.

The Commissioner, within the applicable period of limitations, may credit any overpayment of tax, including interest thereon, against any outstanding liability for any tax (or for any interest, additional amount, addition to the tax, or assessable penalty) owed by the person making the overpayment and the balance, if any, shall be refunded, subject to sections 6402(c) and (d) and the regulations thereunder, to that person by the Commissioner.

Par. 3. Section 301.6402-3(a)(6) is revised to read as follows:

§301.6402-3 Special rules applicable to income tax.

(a) * * *

(6) Notwithstanding paragraph (a)(5)

of this section, the Internal Revenue Service, within the applicable period of limitations, may credit any overpayment of individual, fiduciary, or corporation income tax, including interest thereon, against—

(i) First, any outstanding liability for any tax (or for any interest, additional amount, additions to the tax, or assessable penalty) owed by the taxpayer making the overpayment;

(ii) Second, in the case of an individual taxpayer, amounts of past-due support assigned to a State under section 402(a)(26) or 471(a)(17) of the Social Security Act under procedures set forth in the regulations under section 6402(c);

(iii) Third, past-due and legally enforceable debt under procedures set forth in the regulations under section 6402(d); and

(iv) Fourth, qualifying amounts of past-due support not assigned to a State under procedures set forth in the regulations under section 6402(c).

Only the balance, if any, of the overpayment remaining after credits described in this paragraph (a)(6) shall be treated in the manner so elected.

* * * * *

Par. 5. The following new section is added immediately after §301.6402-5 to read as follows:

§301.6402-6T Offset of past-due legally enforceable debt against overpayment. (Temporary)

(a) *General rule.* (1) A Federal agency (as defined in section 6402(f)) that has entered into an agreement with the Internal Revenue Service with regard to its participation in the tax refund offset program and that is owed a past-due legally enforceable debt may notify the Internal Revenue Service, pursuant to the terms of such agreement, of past-due legally enforceable debts owed to such agency that are to be collected by tax refund offset. The Service shall, after making appropriate credits as provided by §301.6402-3(a)(6)(i) and (ii), reduce the amount of any overpayment payable to a taxpayer by the amount of any past-due legally enforceable debt owed to such agency of which the Service has been properly notified. This section does not apply to any debt incurred by an overpayment of benefits to a taxpayer under Title II of the Social Security Act (OASDI overpayment) or debt subject to section 464 of the Social Security Act (past-due support).

(2) For purposes of the pilot tax refund offset program, the Commissioner of Internal Revenue will identify those Federal agencies eligible to enter into the agreement with the Service described in paragraph (a)(1) of this section.

(b) *Past-due legally enforceable debt eligible for refund offset.* For purposes of this section, a past-due legally enforceable debt which may be referred by a Federal agency to the Service for offset is a debt—

(1) which, except in the case of a judgment debt, has been delinquent for at least three months but has not been delinquent for more than ten years at the time the offset is made;

(2) which cannot be currently collected pursuant to the salary offset provisions of-5 U.S.C. 5514(a)(1);

(3) which is ineligible for administrative offset under 31 U.S.C. 3716(a) by reason of 31 U.S.C. 3716(c)(2), or cannot be currently collected by administrative offset under 31 U.S.C. 3716(a) by the referring agency against amounts payable to the debtor by the referring agency;

(4) with respect to which FAS the agency has given the taxpayer at least 60 days to present evidence that all or part of the debt is not past-due or legally enforceable, has considered evidence presented by such taxpayer, and determined that an amount of such debt is past-due and legally enforceable;

(5) which has been disclosed by such agency to a consumer reporting agency as authorized by 31 U.S.C. 3711(f), in the case of a debt to be referred to the Service after June 30, 1986;

(6) with respect to which that the agency has notified, or has made a reasonable attempt to notify, the taxpayer that—

(i) the debt is past due, and

(ii) unless repaid within 60 days thereafter, will be referred to the Service for offset against any overpayment of tax; and

(7) which is at least $25.

(c) *Time and content of notification of liability for past-due legally enforceable debt.* (1) A Federal agency must submit a notification of a taxpayer's liability for past-due legally enforceable debt to the Service on magnetic tape by December 1 of each year. Such notification must contain—

(i) The name and identifying number (as defined in section 6109) of the taxpayer who is responsible for the debt;

(ii) The amount of such past-due and legally enforceable debt;

(iii) The date on which the debt became past-due;

(iv) The designation of the Federal agency or subagency submitting the notification of liability and identification of the agency program under which the debt was incurred.

(2) Accompanying each magnetic tape, the agency must submit a statement certifying that, with respect to each debt reported on the tape, all of the requirements of §301.6402-6(b) have been satisfied.

(d) *Correction of notification.* If, after submitting to the Service notification of liability for past-due legally enforceable debt as provided by paragraph (c), an agency determines that an error has been made with respect to the information contained in the notification, or if an agency receives a payment or credits a payment to the account of a taxpayer named in this notification, the agency shall promptly notify the Service, which shall make the appropriate correction of its records. However, this paragraph does not apply to a subsequent increase in the amount of past-due legally enforceable debt owed by a taxpayer named in an agency's original notification to the Service.

(e) *Priorities for offset.* (1) An overpayment shall be reduced first by the amount of an outstanding liability for any tax under section 6402(a); second, by the amount of any past-due support assigned to a State under section 402(a)(26) or 471(a)(17) of the Social Security Act which is to be offset under section 6402(c) and the regulations thereunder; third, by the amount of any past-due legally enforceable debt owed to a Federal agency under section 6402(d) and this section; and fourth, by the amount of any qualifying past-due support not assigned to a State which is to be offset under section 6402(c) and the regulations thereunder.

(2) If a taxpayer owes more than one past-due legally enforceable debt to a

Federal agency or agencies, the overpayment shall be credited against the debts in the order in which the debts accrued. A debt shall be considered to have accrued at the time at which the debt became past due.

(3) Reduction of the overpayment pursuant to section 6402(a), (c) and (d) shall occur prior to crediting of the overpayment to any future liability for an internal revenue tax. Any amount remaining after offset under section 6402(a), (c) and (d) shall be refunded to the taxpayer, or applied to estimated tax, if elected by the taxpayer.

(f) *Notice of offset.* The Service shall notify the taxpayer in writing of the amount and date of the offset for past-due legally enforceable debt and of the Federal agency to which this amount has been paid or credited. Such notice shall include a notification to any other person who may have filed a joint return with the taxpayer of the steps which such other person may take in order to secure his or her proper share of the refund. The Service shall advise each agency on a monthly basis of the names, mailing addresses and identifying numbers of the taxpayers from whom amounts of past-due legally enforceable debt were collected and of the amounts collected from each taxpayer. If the refund from which an amount of past-due legally enforceable debt is to be withheld is based upon a joint return, the Service shall so notify the agency, and furnish the names and address of each taxpayer filing such joint return.

(g) *Offset made with regard to refund based upon joint return.* If the person filing the joint return with the taxpayer owing the past-due legally enforceable debt takes appropriate action to secure his or her proper share of a refund from which a withholding was made, the Service shall pay such person his or her share of the refund and shall deduct that amount from amounts subsequently payable to the agency to which the amount withheld was originally paid.

(h) *Disposition of amounts collected.* Amounts collected under this section shall be transferred to a special account maintained by the Bureau of Financial Management Services for each Federal agency. If an erroneous payment is made to any agency, the Service shall deduct the amount of such payment from amounts subsequently payable to the agency to which the amount withheld was originally paid.

(i) *Fees.* Refund offset fees in amounts determined to be sufficient to reimburse the Service for the full cost of the offset procedure prescribed by this section shall be billed to, and collected from, the participating Federal agencies. The fees shall be deposited in the United States Treasury and credited to the appropriation accounts of the Service which bore all or part of the costs involved in administering the refund offset procedures.

(j) *Review of offset of refunds.* Any reduction of a taxpayer's refund made pursuant to section 6402(c) or (d) shall not be subject to review by any court of the United States or by the Service in an administrative proceeding. No action brought against the United States to recover the amount of any such reduction shall be considered to be a suit for refund of tax. Any legal, equitable or administrative action by any person seeking to recover the amount of the reduction of the overpayment must be taken against the Federal agency to which the amount of the reduction was paid.

(k) *Effective date.* This section applies to refunds payable under section 6402 of the Internal Revenue Code after December 31, 1985, and before January 1, 1988.

There is need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impractical to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

JAMES I. OWENS,
Acting Commissioner of Internal Revenue.

Approved September 19, 1985.

RONALD A. PEARLMAN,
Assistant Secretary of Treasury.

(Filed by the Office of the Federal Register on September 27, 1985, 8:45 a.m., and published in the issue of the Federal Register for September 30, 1985, 50 F.R. 39661)

Section 6412.—Floor Stock Refunds

26 CFR 48.6412: Floor stocks credit or refund.

Procedures to be followed in claiming the credit or refund for manufacturers excise taxes paid in respect to certain articles held by dealers as floor stocks. See T.D. 8043, page 214.

Section 6416.—Certain Taxes on Sales and Services

26 CFR 48.6416(a)-1: Claims for credit or refund of overpayments of taxes on special fuels and manufacturers taxes.

Procedures to followed in claiming a credit or refund of overpayments of certain excise taxes. See T.D. 8043, page 214.

Section 6420.—Gasoline Used on Farms

26 CFR 48.6420-1: Credits or payments to ultimate purchases of gasoline used on a farm.

Allowance of income tax credit or payment in respect of gasoline used on a farm for farming purposes. See T.D. 8043, page 214.

Section 6421.—Gasoline Used for Certain Nonhighway Purposes or by Local Transit Systems

26 CFR 48.6421-1: Credits or payments to ultimate purchaser of gasoline used for certain nonhighway purposes.

Allowance of income tax credit or payment in respect of gasoline used in a qualified business use or as fuel in certain aircraft. See T.D. 8043, page 214.

Section 6424.—Lubricating Oil Used for Certain Nontaxable Purposes

26 CFR 48.6424-1: Credits or payments to ultimate purchaser of lubricating oil used in a qualified business use or in a qualified bus.

Allowance of income tax credit or payment in respect of lubricating oil used in a qualified business use or in a qualified bus. See T.D. 8043, page 214.

Section 6427.—Fuel Not Used for Taxable Purposes

26 CFR 48.6427-1: Credit or payments to purchaser of special fuels resold or used for nontaxable, farming, or other purpose.

Allowance of income tax credit or payment in respect of special fuels used for nontaxable, farming, or other purposes. See T.D. 8043, page 214.

26 CFR 48.6427-6: Limitation on credit or re-

fund of tax paid on fuel used in intercity, local or school buses after July 31, 1984.

Imposition of tax on use of heavy vehicles and credits and refunds of tax on sale of diesel fuel. See T.D. 8027, page 263.

Section 6430.—Credit or Refund of Windfall Profit Taxes to Certain Trust Beneficiaries

26 CFR 51.6430-1: Credit or refund of windfall profit tax to certain trust beneficiaries.

Credit or refund of windfall profit tax paid by a trust. See T.D. 8055, page 278.

Subchapter 67.—Interest
Subchapter C.—Determination of Interest Rate; Compounding of Interest

Section 6621.—Determination of Rate of Interest

26 CFR 301.6621-1: Interest rate.

Adjusted interest rate; underpayments and overpayments. The adjusted rate of interest on underpayments and overpayments, as determined under section 6621(b) of the Code, will decrease from 11 to 10 percent on January 1, 1986.

Rev. Rul. 85-169

Section 6621(b) of the Internal Revenue Code provides for semiannual adjustment of the interest rate established under that section. Section 6621(b)(1) requires that these adjustments in the rate be established by October 15 and April 15, and be based on the average prime interest rate for the six-month period ending the previous September 30 or March 31, respectively.

The Board of Governors of the Federal Reserve System has determined that the average prime interest rate for the six-month period ending September 30, 1985, was 9.85 percent. That rate, rounded to the nearest full percent, is 10 percent, a change of 1 percent from the rate of 11 percent in effect under the last determination made by the Internal Revenue Service. *See* Rev. Rul. 85-47, 1985-1 C.B. 367. Accordingly, an adjusted rate of interest of 10 percent is established under section 6621(b). The adjusted rate will take effect on January 1, 1986, and will apply to amounts outstanding on that date or arising thereafter.

Daily rates for compound interest for 10 percent were published in Table 16 of Rev. Proc. 83-7, 1983-1 C.B. 583, 599.

PERIOD	RATE
February 1, 1980-January 31, 1982	12%
February 1, 1982-December 31, 1982	20%
January 1, 1983-June 30, 1983	16%*
July 1, 1983-December 31, 1983	11%*
January 1, 1984-June 30, 1984	11%*
July 1, 1984-December 31, 1984	11%*
January 1, 1985-June 30, 1985	13%*
July 1, 1985-December 31, 1985	11%*

*Compond Interest

Chapter 68.—Additions to the Tax, Additional Accounts, and Assessable Penalties
Subchapter B.—Assessable Penalties

Section 6675.—Excessive Claims With Respect to the Use of Certain Fuels

26 CFR 48.6675-1: Excessive claims under section 6420, 6421, 6424, or 6427.

Civil penalty with respect to excessive claims relating to the use of certain gasoline and lubricating oil. See T.D. 8043, page 214.

Section 6679.—Failure to File Returns With Respect to Foreign Corporations or Foreign Partnerships

26 CFR 301.6679-1: Failure to file returns, etc. with respect to foreign corporations or foreign partnerships for taxable years beginning after September 3, 1982.

Information returns required of officers, directors, and shareholders of foreign personal holding companies. See T.D. 8028, page 288.

Section 6694.—Understatement of Taxpayer's Liability by Income Tax Return Preparer

26 CFR 1.6694-1: Understatement of taxpayer's liability by income tax return preparer.

Whether a firm that furnishes a computerized tax return preparation services to tax practitioners may be subject to penalties under section 6694 of the Code. See Rev. Rul. 85-187, page 338.

26 CFR 1.6694-1: Understatement of taxpayer's liability by income tax return preparer.

Whether a farmers cooperative credit association and its employees who prepare Schedule F of Form 1040 may be subject to penalties under section 6694 of the Code. See Rev. Rul. 85-188, page 339.

26 CFR 1.6694-1: Understatement of taxpayer's liability by income tax return preparer.

Whether a person who prepares a computer program and sells it to a taxpayer to use in preparing the taxpayer's income tax return may be subject to penalties under section 6694 of the Code. See Rev. Rul. 85-189, page 341.

Section 6695.—Other Assessable Penalties With Respect to the Preparation of Income Tax Returns for Other Persons

26 CFR 1.6695-1: Other assessable penalties with respect to the preparation of income tax returns for other persons.

Whether the penalties under section 6695 of the Code apply to a firm that furnishes a computerized tax return preparation service to tax practitioners. See Rev. Rul. 85-187, page 338.

26 CFR 1.6695-1: Other assessable penalties with respect to the preparation of income tax returns for other persons.

Whether the penalties under section 6695 of the Code apply to a farmers cooperative credit association and its employees who prepare Schedule F of Form 1040. See Rev. Rul. 85-188, page 339.

26 CFR 1.6695-1: Other assessable penalties with respect to the preparation of income tax returns for other persons.

Whether the penalties under section 6695 of the Code apply to a person who prepares a computer program and sells it to a taxpayer to use in preparing the taxpayer's income tax return. See Rev. Rul. 85-189, page 341.

Chapter 74.—Closing Agreements and Compromises

Section 7121.—Closing Agreements

26 CFR 301.7121-1: Closing agreements.

Conditions under which the Service will issue an advance ruling and enter into a closing agreement permitting a variation from the general rule of section 1.1017-1 of the regulations relating to the adjustment to basis of depreciable property resulting from discharge of indebtedness under section 108 of the Code. See Rev. Proc. 85-44, page 504.

Chapter 75.—Crimes, Other Offenses, and Features
Subchapter A.—Crimes
Part I.—General Provisions

Section 7216.—Disclosure or Use of Information by Preparers of Returns

26 CFR 301.7216-1: Penalty for disclosure or use of tax return information.

Whether the criminal penalty under section 7216 of the Code applies to a firm that furnishes a computerized tax return preparation service to tax practitioners. See Rev. Rul. 85-187, page 338.

26 CFR 301.7216-1: Penalty for disclosure or use of tax return information.

Whether the criminal penalty under section 7216 of the Code applies to a farmers cooperative credit association and its employees who prepare Schedule F of Form 1040. See Rev. Rul. 85-188, page 339.

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26 CFR 301.7216-1: Penalty for disclosure or use of tax return information.

Whether the criminal penalty under section 7216 of the Code applies to a person who prepares a computer program and sells it to a taxpayer to use in preparing the taxpayer's income tax return. See Rev. Rul. 85-189, page 341.

Chapter 79.—Definitions

Section 7701.—Definitions

26 CFR 301.7701-1: Definitions.

The term "person" for purposes of the reporting requirements of section 6041 of the Code is sufficiently broad to include a governmental body such as an Indian tribal government. See Rev. Rul. 85-194, page 301.

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26 CFR 301.7701-2: Associations.

Limited partnerships. Idaho, Iowa, Washington, and Wyoming are added to the list of states that have enacted legislation that corresponds to the Uniform Limited Partnership Act for purposes of section 301.7701-2 of the regulations. Rev. Rul. 84-80 amplified.

Rev. Rul. 85-178

In Rev. Rul. 84-80, 1984-1 C.B. 275, and Rev. Rul. 84-180, 1984-2 C.B. 314, the Internal Revenue Service listed several states that revised their limited partnership statutes after the promulgation of the Revised Uniform Limited Partnership Act. The Service determined that the legislation enacted by those states corresponds to the Uniform Limited Partnership Act ("ULPA") for purposes of section 301.7701-2 of the Regulations on Procedure and Administration.

The Service has determined that the following additional states have enacted legislation that, as of the effective date, corresponds to ULPA for purposes of section 301.7701-2 of the regulations:

IDAHO: Idaho Code sections 53-201 through 53-267 (Supp. 1984) effective January 1, 1982.

IOWA: Iowa Code Ann. sections 545.101 through 545.1106 (West Supp. 1984) effective July 1, 1982.

WASHINGTON: Wash. Rev. Code Ann. sections 25.10.010 through 25.10.690 (Supp. 1984) effective January 1, 1982.

WYOMING: Wyo. Stat. sections 17-14-201 through 17-14-1104 (Supp. 1984) effective July 1, 1979.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 84-80 is amplified.

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26 CFR 301.7701-15: Income tax return preparer.
(Also Sections 6107, 6109, 6694, 6695, 7216; 1.6107-1, 1.6109-2, 1.6694-1, 1.6695-1, 301.7216-1.)

Return preparers; computerized tax return preparation service. A firm that furnishes a computerized tax return preparation service to tax practitioners is an income tax return preparer when the program used goes beyond mere mechanical assistance.

Rev. Rul. 85-187

ISSUE 1

In the situation described below, is a firm that furnishes a computerized tax return preparation service to tax practitioners an income tax return preparer under section 7701(a)(36) of the Internal Revenue Code?

ISSUE 2

If so, what requirements and/or penalties will apply?

FACTS

X is a firm that offers a computerized tax preparation service to tax practitioners such as attorneys and certified public accountants, including *A*. Practitioners such as *A* fill out sheets with information about their clients' income, deductions, etc. This work sheet requires the practitioners to make substantive determinations about categorization of income, allowability of deductions, etc. The practitioners forward the information to *X*, whose employees enter the information into *X*'s computer, which has been programmed to produce a completed Form 1040, U.S. Individual Income Tax Return, together with appropriate supporting schedules. *X* then forwards the completed returns to the practitioners, who normally sign the clients' returns as preparers and give the returns to the clients. *X* does not deal directly wi the public.

In 1984, *B* a client of *A*, came to with information concerning incon and deductions for the tax year 198 and requested that *A* prepare For 1040 for 1983. *A* studied the inform tion, asked the requisite questions of completed *X*'s worksheet, and mail the worksheet to *X*. *X* then furnished completed Form 1040 for *B* to *A*. signed the return and gave it to *B*, w filed the return with the Internal Rev nue Service.

The program that *X* used computing the tax on *B*'s 1983 retu included a computation of an Accel ated Cost Recovery System (ACR deduction under section 168 of t Code with respect to property tha put into service during 1983. computing the allowable deduction, program did not reduce the basis of property by 50 percent of the amo of the credit claimed under secti 46(a)(2), as required by section 48 as in effect for 1983. *X*'s progr would have correctly computed *B*'s under the law in effect for 1982 bef the amendment made by the Tax Equ and Fiscal Responsibility Act of 19 section 205(a), 1982-2 C.B. 462, 4 *X*, however, failed to reprogram system to take this change into acco

In 1984, the Service examined return and determined that the failur reduce the basis of *B*'s property cau an understatement of tax.

LAW AND ANALYSIS

ISSUE 1

Section 7701(a)(36)(A) of the C defines an income tax return prep as any person who prepares any re of tax, or any claim for refund of imposed by subtitle A, for compe tion, or any person who employs or more persons to prepare such ret or claims for refund for compensat

Section 7701(a)(36)(B)(i) of Code provides that a person merely furnishes typing, reproduci or other mechanical assistance is no income tax return preparer.

The Code and the regulations template that more than one person be a preparer with respect to a give turn or claim for refund. For exam section 301.7701-15(a) of the Reg tions on Procedure and Administra

defines an income tax return preparer as any person who actually prepares the return as well as any person who employs (or engages) one or more persons to prepare a return. Similarly, section 301.7701-15(b)(1) of the regulations, in discussing whether preparation of a portion of a return is considered preparation of the return as a whole, speaks of "persons acting in concert". Thus, in this case, the fact that *A* is the preparer of *B*'s return does not mean that *X* could not also be considered a preparer because *A* has engaged *X* for assistance in preparing a complete return for *B*.

X is considered a preparer with respect to *B*'s return because *X*'s calculations go beyond mere mechanical assistance to *A*. *X*'s program has made substantive determinations concerning the application of section 48(q) in computing how much is deductible with respect to *B*'s ACRS deduction, and goes beyond merely furnishing typing, reproducing, or other mechanical assistance.

ISSUE 2

Sections 6694(a) and 6694(b) of the Code provide that any person who is an income tax return preparer may be subject to a penalty if any part of an understatement of liability with respect to a return or claim for refund is due to a negligent or intentional disregard of rules or regulations by an income tax return preparer, or if the understatement is due to a willful attempt to understate the liability by an income tax return preparer.

Rev. Proc. 80-40, 1980-2 C.B. 774, provides guidelines for the application of the penalty under section 6694(a) of the Code. Under section 4.01 of Rev. Proc. 80-40, the following factors will be taken into consideration in determining whether to assert the penalty: The nature of the error causing the understatement; the frequency of errors; and the materiality of errors. Additionally, under section 4.02 of Rev. Proc. 80-40, the preparer's office practice will be taken into account in determining whether to assert the penalty.

Under section 6107(a) of the Code, an income tax return preparer has an obligation to furnish a copy of the return to the taxpayer and may be penalized under section 6695(a) for failure to do so. Under section 6107(b), an income tax return preparer has an obligation to retain a copy of the return or a list of taxpayers for whom returns have been prepared and may be penalized under section 6695(d) for failure to do so. When one preparer employs or engages another, the responsibility for these acts falls on the employer. *See* section 1.6107-1(c)(1) of the Income Tax Regulations.

Section 6695(b) of the Code imposes an obligation to sign the return and imposes a penalty for failure to do so. Under section 1.6695-1(b)(2) of the regulations, this obligation falls on the person with primary responsibility for the overall subtantive accuracy of the return, and not on every person who may be a preparer with respect to that return.

Section 6109(a)(4) of the Code imposes an obligation on preparers to furnish their identifying numbers. Under section 1.6695-1(c)(2) of the regulations, the penalty for failure to do so under section 6695(c) of the Code does not fall on a preparer engaged by another preparer.

Under sections 6060 of the Code and 1.6060-1 of the regulations, any person who employs an income tax return preparer must retain a record concerning each preparer so employed and may be penalized under section 6695(e) for failure to do so.

Section 6695(f) of the Code imposes a penalty on income tax return preparers who endorse or otherwise negotiate refund checks that are issued to taxpayers.

Section 7216 of the Code imposes a criminal penalty for unlawful disclosure or use of return information by persons who prepare returns or provide services in connection with the preparation of returns.

HOLDINGS

ISSUE 1

X is an income tax return preparer with respect to *B*'s 1983 income tax return.

ISSUE 2

As an income tax return preparer, *X* may be subject to a number of requirements and penalties. *X* is potentially subject to a penalty under sections 6694(a) or 6694(b) of the Code if any part of an understatement of liability with respect to *B*'s return is due to a negligent or intentional disregard of rules or regulations by *X*, or if the understatement is due to *X*'s attempt to willfully understate the liability. In order to determine whether the penalty under section 6694(a) will be asserted, the factors discussed in sections 4.01 and 4.02 of Rev. Proc. 80-40 must be considered.

The responsibility for furnishing a copy of the return to *B* and for retaining a list of taxpayers for whom returns have been prepared falls on *A*. Accordingly, *X* is not subject to the penalties under sections 6695(a) or 6695(d) of the Code.

Because *A* had primary responsibility for the overall substantive accuracy of *B*'s return, *A* correctly signed the return as preparer and *X* is not subject to the penalty under section 6695(b) of the Code for failure to do so.

Because *X* was engaged by *A*, *A*'s identifying number and not *X*'s should be shown on *B*'s return. *X* is not subject to the penalty under section 6695(c) of the Code.

Under section 6060 of the Code, *X* must keep a record of any person in its employ that meets the definition of income tax return preparer. *X* is subject to the penalty under section 6695(e) of the Code for failure to do so.

X may be penalized under section 6695(f) of the Code if *X* endorses or otherwise negotiates a refund check issued to *B*.

X may be subject to the criminal penalty under section 7216 of the Code if *X* makes an unlawful disclosure or use of return information.

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26 CFR 301.7701-15: Income tax return preparer.
(Also Sections 6107, 6109, 6694, 6695, 7216; 1.6107-1, 1.6109-2, 1.6694-1, 1.6695-1, 301.7216-1.)

Return preparers; farmers cooperative credit association. A farmers cooperative credit association that prepares Schedule F of Form 1040 as part of a computerized data processing system provided to members is an income tax return preparer if the Schedule F is a substantial portion of a member's return.

Rev. Rul. 85-188

ISSUE 1

Are a farmers cooperative credit as-

sociation and its employees who prepare Schedule F of Form 1040 (Farm Income and Expenses) income tax return preparers under section 7701(a)(36) of the Internal Revenue Code under the circumstances described below?

ISSUE 2

If so, what requirements and/or penalties will apply?

FACTS

X, a farmers cooperative credit association, lends money to member farmers. In connection with this activity, *X* markets a computerized data processing system which it provides to its members as a service. Using information submitted by members of the cooperative, the system provides a variety of schedules and summaries dealing with each member's financial operations, including a completed Schedule F, a Form W-2 (Wage and Tax Statement), and a Form 941 (Employer's Quarterly Federal Tax Return) for reporting withheld income tax and Federal Insurance Contribution Act taxes. To complete the Schedule F the computer has been programmed to figure the amount of allowable depreciation and to make other tax computations based on the information fed into it.

Some members do not want all these items and request only the schedules and summaries they feel would be useful. *X* charges a standard fee regardless of whether its members receive all of the information provided.

A, an employee of *X*, is responsible for explaining the computer system to potential members, helping members assemble and code data for input into the system, reviewing the items furnished to the members, and performing other duties not directly related to administration of the system. *A* is familiar with both the financial and operational aspects of farming and has knowledge of farm finance and individual income taxation. *A* may advise the members on how to classify tax items when assisting them. *A* also reviews the completed forms to ensure that the correct information is fed into the computer so that forms are completed properly. *A* does not, however, purport be a tax specialist and does not prepare Form 1040 (U.S. Individual Income Tax Return) for members. Such returns are usually prepared by other income tax return preparers or by the members themselves.

LAW AND ANALYSIS

ISSUE 1

Section 7701(a)(36) of the Code defines an income tax return preparer as any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by subtitle A or any claim for refund of tax imposed by subtitle A. The preparation of a substantial portion of a return or claim for refund is treated as if it were the preparation of the return or claim. Persons who merely furnish typing, reproducing, or other mechanical assistance are excepted from the definition of preparer.

Section 301.7701-15(b) of the Regulations on Procedure and Administration provides that only a person (or persons acting in concert) who prepares all or a substantial portion of a return or claim is considered a preparer. A person who gives advice directly relevant to the determination of the existence, characterization, or amount of an entry on a return or claim is regarded as having prepared that entry. Whether a schedule, entry, or other portion of a return or claim is a substantial portion of the return or claim is determined by comparing the length and complexity of, and the tax liability or refund involved in, that portion to the length and complexity of, and tax liability or refund involved in, the return or claim for refund as a whole.

To be a preparer under section 7701(a)(36) of the Code, a person must satisfy all the elements of the definition of preparer. In summary, the person must prepare a return for compensation or employ a person who is a preparer with respect to a return or claim.

Form W-2 and Form 941 are specifically excluded from the definition of income tax returns by section 301.7701-15(c)(1)(ii) of the regulations. Schedule F, while not a return in itself, may be a substantial portion of a return if it meets the criteria in section 301.7701-15(b).

Because the amount of depreciation and other tax computations are made for members, the data processing system has been programmed to make sub stantive tax determinations. *A*'s assis ance to the members involve substantive tax advice in instance where *A* makes determinations abo how tax items are to be classified wh providing the assistance.

The members pay an amount for t use of the entire system, includi preparation of Schedule F. *A* is co pensated for duties, including those lated to the operation of the system, though many of *A*'s duties do n involve preparation of Schedule F.

ISSUE 2

Sections 6694(a) and 6694(b) of t Code provide that any person who is income tax return preparer may be su ject to a penalty if any part of an und statement of liability with respect t return or claim for refund is due t negligent or intentional disregard rules or regulations by an income return preparer, or if the understa ment is due to a willful attempt to derstate the liability by an income return preparer.

Rev. Proc. 80-40, 1980-2 C.B. 7 provides guidelines for the applica of the penalty under section 6694(a the Code. Under section 4.01 of R Proc. 80-40, the following factors be taken into consideration in deter ing whether to assert the penalty: nature of the error causing the un statement; the frequency of errors; the materiality of errors. Additiona under section 4.02 of Rev. P 80-40, the preparer's office prac will be taken into account in deter ing whether to assert the penalty.

Under section 6107(a) of the C an income tax return preparer ha obligation to furnish a copy of th turn to the taxpayer and may be p ized under section 6695(a) for failu do so. Under section 6107(b), a come tax return preparer has an ob tion to retain a copy of the return list of taxpayers for whom returns been prepared and may be pena under section 6695(d) for failure so. When one preparer employs gages another, the responsibilit these acts falls on the employer section 1.6107-1(c)(1) of the In Tax Regulations.

Section 6695(b) of the Code im an obligation to sign the retur

imposes a penalty for failure to do so. Under section 1.6695-1(b)(2) of the regulations, this obligation falls on the person with primary responsibility for the overall substantive accuracy of the return, and not on every person who may be a preparer with respect to that return.

Section 6109(a)(4) of the Code imposes an obligation on preparers to furnish their identifying numbers. Under section 1.6695-1(c)(2) of the regulations, the penalty for failure to do so imposed by section 6695(c) of the Code does not fall on a preparer engaged by another preparer.

Under sections 6060 of the Code and 1.6060-1 of the regulations, any person who employs an income tax return preparer must retain a record concerning each preparer so employed and may be penalized under section 6695(e) for failure to do so.

Section 6695(f) of the Code imposes a penalty on income tax return preparers who endorse or otherwise negotiate refund checks that are issued to taxpayers.

Section 7216 of the Code imposes a criminal penalty for unlawful disclosure or use of return information by persons who prepare returns or provide services in connection with the preparation of returns.

HOLDING

ISSUE 1

Preparation of a Schedule F by *X*'s computerized data processing system is preparation of a federal income tax return under section 7701(a)(36) of the Code only when the Schedule F constitutes a substantial portion of a Form 1040 filed by a taxpayer. Thus, *X* is an income tax return preparer with respect to such a return. *A* also is considered an income tax return preparer with respect to such a return when *A* makes independent determinations about what items should be fed into the computer (i.e., which items are deductible, which are not) or how the information on completed forms should be categorized.

ISSUE 2

In those situations in which *X* is considered an income tax return preparer because Schedule F constitutes a substantial portion of the return, *X* may be subject to the following requirements and/or penalties:

X is potentially subject to a penalty under sections 6694(a) or 6694(b) of the Code if any part of an understatement of liability with respect to a member's return is due to a negligent or intentional disregard of rules or regulations by *X* or if the understatement is due to *X*'s attempt to willfully understate the liability. In order to determine whether the penalty under section 6694(a) will be asserted, the factors discussed in sections 4.01 and 4.02 of Rev. Proc. 80-40 must be considered. Similarly, *A* also is potentially subject to such a penalty if *A* is a preparer with respect to a return.

X must furnish a copy of Schedule F to members and retain a list of taxpayers for whom schedules have been prepared and may be penalized under sections 6695(a) and 6695(d) of the Code for failure to do so.

Because neither *X* nor its employees has primary responsibility for the overall substantive accuracy of a member's return, neither *A* nor *X* is required to sign a return and neither is subject to the penalty for failure to do so. Similarly, neither *X*'s nor *A*'s identifying number need appear on the return.

Under section 6060 of the Code, *X* must keep a record of *A* and any other person in its employ that meets the definition of income tax return preparer. *X* is subject to the penalty under section 6695(e) for failure to do so.

X may be penalized under section 6695(f) of the Code if *X* endorses or otherwise negotiates a refund check issued to a member for whom a Schedule F was prepared.

Both *X* and *A* may be subject to the criminal penalty under section 7216 of the Code if either makes an unlawful disclosure or use of return information. This penalty could apply even if Schedule F does not constitute a substantial portion of a return and even if *A* is not an income tax return preparer because of the absence of independent determinations with respect to a given return.

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26 CFR 301.7701-15: Income tax return preparer.

(Also Sections 6107, 6109, 6694, 6695, 7216; 1.6107-1, 1.6109-2, 1.6694-1, 1.6695-1, 301.7216-1.)

Return preparers; sale of computer program. A person who prepares a computer program and sells it to a taxpayer to use in preparing the taxpayer's income tax return may be an income tax return preparer.

Rev. Rul. 85-189

ISSUE 1

Is a person who prepares a computer program and sells it to a taxpayer to use in preparing the taxpayer's income tax return considered an income tax return preparer within the meaning of section 7701(a)(36) of the Internal Revenue Code under the circumstances described below?

ISSUE 2

If so, what requirements and/or penalties will apply?

FACTS

X has prepared a computer program that is to be used to complete Form 1040, U.S. Individual Income Tax Return, for calendar year 1983 and that *X* sells to customers. *A*, a customer of *X*, used the program to complete *A*'s Form 1040 for calendar year 1983 without any assistance from *X*. *A* entered figures into a computer after the computer program explained the requirements for each entry on the return (that is, what constitutes income, what items are deductible, which persons may be claimed as dependents, etc). The computer is programmed to calculate some return items for the taxpayer based on the information fed into it. For example, the program determines whether the taxpayer is eligible for various deductions and credits and the amounts allowable. The computer prints the figures for all the lines of the return on a line printer. *X* designed the computer program so that customers can use it even if they are not familiar with the provisions of the Code and regulations.

The program used in computing the tax on *A*'s 1983 return included a computation of an Accelerated Cost Recovery System (ACRS) deduction under section 168 of the Code with respect to property that *A* put into service during 1983. In computing the allowable deduction, *X*'s program did not reduce the basis of the property by 50 percent of the amount of the credit claimed under section 46(a)(2), as required by section 48(q) as in effect for 1983. *X*'s pro-

gram would have correctly computed *A*'s tax under the law in effect for 1982 before the amendment made by the Tax Equity and Fiscal Responsibility Act of 1982, section 205(a), 1982-2 C.B. 462, 474. However, *X* failed to reprogram the program for 1983 to take this change into account.

In 1984, the Service examined *A*'s return and determined that the failure to reduce the basis of *A*'s property caused an understatement of tax.

LAW AND ANALYSIS

ISSUE 1

Section 7701(a)(36)(A) of the Code defines an income tax return preparer as any person who prepares any return of tax, or any claim for refund of tax, imposed by subtitle A, for compensation, or any person who employs one or more persons to prepare such returns or claims for refund for compensation.

Section 7701(a)(36)(B)(i) of the Code provides that a person who merely furnishes typing, reproducing, or other mechanical assistance is not an income tax return preparer.

Section 301.7701-15(a)(1) of the Regulations on Procedure and Administration provides that if a person furnishes a taxpayer or other preparer enough information and advice to make completing the return or claim for refund largely a mechanical or clerical matter, the person is considered an income tax return preparer, even if he or she does not actually place or review information on the return or claim for refund.

The determination of whether *X* is considered the preparer of *A*'s return does not depend on whether *X* or *X*'s employees personally reviewed the completed return or whether *X* or *X*'s employees actually placed any of the figures on the return. Rather, such a determination depends on whether *X* has given substantive tax instructions in the computer program.

X is considered a preparer with respect to *A*'s return because *X*'s computer program provides more than mere mechanical assistance. Substantive determinations are performed by *X*'s computer program concerning the application of section 48(q) of the Code to the factual information supplied by *A*.

ISSUE 2

Sections 6694(a) and 6694(b) of the Code provide that any person who is an income tax return preparer may be subject to a penalty if any part of an understatement of liability with respect to a return or claim for refund is due to a negligent or intentional disregard of rules or regulations by an income tax return preparer, or if the understatement is due to a willful attempt to understate the liability.

Rev. Proc. 80-40, 1980-2 C.B. 774, provides guidelines for the application of the penalty under section 6694(a) of the Code. Under section 4.01 of Rev. Proc. 80-40, the following factors will be taken into consideration in determining whether to assert the penalty: the nature of the error causing the understatement; the frequency of errors; and the materiality of errors. Additionally, under section 4.02 of Rev. Proc. 80-40, the preparer's office practice will be taken into account in determining whether to assert the penalty.

Under section 6107(a) of the Code, an income tax return preparer has an obligation to furnish a copy of the return to the taxpayer and may be penalized under section 6695(a) for failure to do so. Under section 6107(b), an income tax return preparer has an obligation to retain a copy of the return or a list of taxpayers for whom returns have been prepared and may be penalized under section 6695(d) for failure to do so.

Section 6695(b) of the Code imposes an obligation on preparers to furnish their identifying numbers and section 6695(c) imposes a penalty for failure to do so.

Under sections 6060 of the Code and 1.6060-1 of the Income Tax Regulations, any person who employs an income tax return preparer must retain a record concerning each preparer so employed and may be penalized under section 6695(e) for failure to do so.

The penalties in sections 6695(a)-(e) do not apply if the failure is due to reasonable cause.

Section 6695(f) of the Code imposes a penalty on income tax return preparers who endorse or other wise negotiate refund checks that are issued to taxpayers.

Section 7216 of the Code imposes a criminal penalty for unlawful disclosure of return information by persons who prepare returns or provide services in connection with the preparation of returns.

HOLDINGS

ISSUE 1

X is an income tax return preparer with respect to *A*'s 1983 income tax return.

ISSUE 2

X is potentially subject to a penalty under sections 6694(a) or 6694(b) of the Code if any part of an understatement of liability with respect to *A*'s return is due to a negligent or intentional disregard of rules or regulations by *X*, or if the understatement is due to *X*'s attempt to willfully understate the liability. In the determination of whether the penalty under section 6694(a) will be asserted, the factors discussed in sections 4.01 and 4.02 of Rev. Proc. 80-40 must be considered.

Sections 6695(a)-(e) of the Code and the regulations thereunder provide that the penalties will not apply if it is shown that the failure is due to reasonable cause and not due to willful neglect. In this case, noncompliance with sections 6695(a)-(e) would be viewed as due to reasonable cause since *X* had no involvement with the actual preparation of the return. Consequently, the penalties under sections 6695(a)-(e) do not apply to *X* under these circumstances.

X may be penalized under section 6695(f) of the Code if *X* endorses or otherwise negotiates a refund check issued to *A*.

X may be subject to the criminal penalty under section 7216 of the Code if *X* makes an unlawful disclosure or use of return information.

Subchapter 80.—General Rules
Subchapter A.—Applications of Internal Revenue Laws

Section 7805.—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

Whether a minister may deduct interest and taxes paid on a personal residence, if the amounts expended are allocable to rental allowance that is otherwise excludable from gross income under a particular section of the Code. See Rev. Rul. 85-96, page 87.

26 CFR 301.7805-1: Rules and regulations.

Whether readily attachable components may be taken into consideration in determining the gross vehicle weight of a vehicle subject to tax under section 4051 of the Internal Revenue Code. See Rev. Rull. 85-196, page 205.

Subchapter C.—Provisions Affecting More Than One Subtitle

Section 7872.—Treatment of Loans With Below-Market Interest Rates

Procedures are set forth for the valuation and reporting requirements for gifts resulting from low-interest and interest-free demand loans outstanding during 1984 and prior years. See Rev. Proc. 85-46, page 507.

Federal short-term, mid-term and long-term rates determined under the alternate method as provided by section 1.1274-6T of the Temporary Income Tax Regulations are set forth for the month of July 1985. See Rev. Rul. 85-91, page 187.

Federal short-term, mid-term and long-term rates determined under the alternate method as provided by section 1.1274-6T of the Temporary Income Tax Regulations are set forth for the month of August 1985. See Rev. Rul. 85-117, page 187.

Federal short-term, mid-term and long term rates determined under the alternate method as provided by section 1.274-6T of the Temporary Income Tax Regulations are set forth for the month of September 1985. See Rev. Rul. 85-137, page 187.

Federal short-term, mid-term and long-term rates determined under the alternate method as provided by section 1.1274-6T of the Temporary Income Tax Regulations are set forth for the month of October, 1985. See Rev. Rul. 85-154, page 188.

What are the applicable federal rates to be used for purposes of section 7872? See Rev. Rul. 85-170, page 186.

Federal short-term, mid-term and long-term rates determined under under the alternate method as provided by section 1.1274-6T of the Temporary Income Tax Regulations are set forth for the month of November 1985. See Rev. Rul. 85-181, page 188.

Federal short-term, mid-term and long-term rates determined under the alternate method as provided by section 1.1274-6T of the Temporary Income Tax Regulations are set forth for the month of 1985. See Rev. Rul. 85-190, page 186.

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26 CFR 1.7872-1: Introduction
(Also Section 4941; 53.4941(d)-2.)

T.D. 8045

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Below Market Loans

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations; final regulations.

SUMMARY: This document contains temporary regulations relating to the Federal tax treatment of both the lender and the borrower in certain below-market interest rate loan transactions. Changes to the applicable law were made by the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. The regulations exempt taxpayers who are parties to certain below-market interest rate loan transactions from the new rules which generally apply to below-market interest rate loans. See the text of the notice of proposed rulemaking * * * [LR-165-84, page 812, this Bulletin] for rules which would affect taxpayers who enter into certain below-market loans and provide them with guidance needed to comply with the law.

DATES: The regulations apply to below-market term loans made after June 6, 1984, and below-market demand loans outstanding after June 6, 1984, and are effective June 6, 1984.

FOR FURTHER INFORMATION CONTACT: Sharon L. Hall of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T), 202-566-4828, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains temporary Income Tax Regulations (26 CFR Part 1) under section 7872 of the Internal Revenue Code of 1954.

IN GENERAL

Prior to the enactment of section 7872, some taxpayers used interest-free loans or loans with an interest rate below the current market rate (in each case, "below-market loans") which purported to circumvent well-established rules of taxation. Thus, in family or similar situations below-market loans have been used which purported to have the effect of avoiding taxation under the grantor trust rules and deflecting income to others. Corporations have made below-market loans to shareholders with the effect of avoiding taxation of income at the corporate level which is the economic equivalent of receiving a deduction for dividends paid to those shareholders. Employers have made below-market loans to employees with the effect of providing compensation which has not been subject to employment taxes. Interest-free loans have also been used to convert non-deductible expenses into the equivalent of deductible expenses.

Section 7872 addresses these and similar practices, generally, by treating certain below-market loans described in one of the categories specified in section 7872(c) as economically equivalent to loans bearing interest at the applicable Federal rate coupled with a payment by the lender to the borrower sufficient to fund the payment of interest by the borrower. Thus, the lender is treated as making (i) a loan to the borrower in exchange for a note requiring the payment of interest at the applicable Federal rate, and (ii) a transfer of funds to the borrower in an amount generally equal to the amount of interest imputed under section 7872. In the case of term gift loans, however, the amount of money treated as transferred by the lender to the borrower which is subject to gift tax, and the amount of the imputed interest payment by the borrower to the lender are unequal because they are calculated differently under the Statute.

EXEMPTION FROM SECTION 7872

These temporary regulations provide for the exemption of certain below-market loans from the rules of section 7872. Section 7872(g)(1)(C) provides regulatory authority for exempting from the application of section 7872 any class of transactions if the application of section 7872 would not have a significant effect on any Federal tax liabil-

ity of the lender or the borrower. Accordingly, these temporary regulations provide that certain below-market loans which are not structured as such for tax avoidance purposes are exempted from the provisions of section 7872. If, however, such a loan is structured as one of the exempted loans for tax avoidance purposes, the Service may recharacterize the transaction according to its economic substance and apply section 7872 in accordance with its terms.

NOTICE OF PROPOSED RULEMAKING

The notice of proposed rulemaking [LR-165-84], which is published * * * [on page 812, this Bulletin] provides taxpayers who enter into certain below-market loans with the guidance needed to comply with section 7872. Accordingly, those proposals would provide rules for determining:

(1) The type of transactions characterized as loans;

(2) The types of below-market loans subject to section 7872;

(3) The timing and amount of transfers in connection with gift, demand and term loans;

(4) The special application of section 7872 to loans made directly between natural persons;

(5) The rule for *de minimis* amount of loans; and

(6) Other special rules.

As a result, these temporary regulations reserve all sections of the regulations other than §1.7872-5T until the proposed regulations are published as either temporary or final regulations.

INAPPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that these temporary regulations are not subject to review under Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required.

REGULATORY FLEXIBILITY ACT

A general notice of proposed rulemaking is not required by 5 U.S.C. 553 for temporary regulations. Accordingly, the temporary regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

DRAFTING INFORMATION

The principal author of these regulations is Howard A. Balikov of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations.

Accordingly, 26 CFR Part 1 is amended as follows:

INCOME TAX REGULATIONS 26 CFR PART 1

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * Section 1.7872 also issued under 26 U.S.C. 7872.

Par. 2. New §§1.7872-1 through 1.7872-4 are added and reserved in the appropriate place.

Par. 3. New §§1.7872-6 through 1.7872-14 are added and reserved in the appropriate place.

Par. 4. New §1.7872-5T is added in the appropriate place. The new section reads as follows:

§1.7872-5T Exempted loans. (Temporary)

(a) *In general*—(1) *General rule.* Except as provided in paragraph (a)(2) of this section, notwithstanding any other provision of section 7872 and the regulations thereunder, section 7872 does not apply to the loans listed in paragraph (b) of this section because the interest arrangements do not have a significant effect on the Federal tax liability of the borrower or the lender.

(2) *No exemption for tax avoidance loans.* If a taxpayer structures a transaction to be a loan described in paragraph (b) of this section and one of the principal purposes of so structuring the transaction is the avoidance of Federal tax, then the transaction will be recharacterized as a tax avoidance loan as defined in section 7872(c)(1)(D).

(b) *List of exemptions.* Except as provided in paragraph (a) of this section, the following transactions are exempt from section 7872:

(1) Loans which are made availa by the lender to the general public the same terms and conditions a which are consistent with the lende customary business practice;

(2) Accounts or withdrawable sha with a bank (as defined in section 58 or an institution to which section 5 applies, or a credit union, made in ordinary course of its business;

(3) Acquisitions of publicly trad debt obligations for an amount equal the public trading price at the time acquisition;

(4) Loans made by a life insuran company (as defined in section 816(a in the ordinary course of its busine to an insured, under a loan right co tained in a life insurance policy and which the cash surrender values a used as collateral for the loans;

(5) Loans subsidized by the Feder State (including the District of Colu bia), or Municipal government (or a agency or instrumentality thereof), a which are made available under a pr gram of general application to th public;

(6) Employee-relocation loans th meet the requirements of paragrap (c)(1) of this section;

(7) Obligations the interest on whic is excluded from gross income unde section 103;

(8) Obligations of the United State government;

(9) Loans to a charitable organiza tion (described in section 170(c), bu only if at no time during the taxabl year will the aggregate outstandin amount of loans by the lender to a such organizations exceed $10,000;

(10) Loans made to or from a foreig person that meet the requirements o paragraph (c)(2) of this section;

(11) Loans made by a private foun dation or other organization describe in section 170(c), the primary purpos of which is to accomplish one or mor of the purposes described in sectio 170(c)(2)(B);

(12) Loans made prior to July 1, 1986, to the extent excepted from the application of section 482 for the 6-month (or longer) period referred to in §1.482-2(a)(3);

(13) For periods prior to July 1, 1986, all money, securities, and property received by a futures commission

merchant or by a clearing organization (i) to margin, guarantee or secure contracts for future delivery on or subject to the rules of a qualified board or exchange (as defined in section 1256(g)(7)), or (ii) to purchase, margin, gurantee or secure options contracts traded on or subject to the rules of a qualified board or exchange, and all money accruing to account holders as the result of such futures and options contracts;

(14) Loans the interest arrangements of which the taxpayer is able to show have no significant effect on any Federal tax liability of the lender or the borrower, as described in paragraph (c)(3) of this section; and

(15) Loans, described in revenue ruling rulings or revenue procedures issued under section 7872(g)(1)(C), if the Commissioner finds that the factors justifying an exemption for such loans are sufficiently similar to the factors justifying the exemptions contained in this section.

(c) *Special rules*—(1) *Employee-relocation loans*—(i) *Mortgage loans.* In the case of a compensation-related loan to an employee, where such loan is secured by a mortgage on the new principal residence (within the meaning of section 217 and the regulations thereunder) of the employee, acquired in connection with the transfer of that employee to a new principal place of work (which meets the requirements in section 217(c) and the regulations thereunder), the loan will be exempt from section 7872 if the following conditions are satisfied:

(A) The loan is a demand loan or is a term loan the benefits of the interest arrangements of which are not transferable by the employee and are conditioned on the future performance of substantial services by the employee;

(B) The employee certifies to the employer that the employer reasonably expects to be entitled to and will itemize deductions for each year the loan is outstanding; and

(C) The loan agreement requires that the loan proceeds be used only to purchase the new principal residence of the employee.

(ii) *Bridge loans.* In the case of a compensation-related loan to an employee which is not described in paragraph (c)(1)(i) of this section, and which is used to purchase a new principal residence (within the meaning of section 217 and the regulations thereunder) of the employee acquired in connection with the transfer of that employee to a new principal place of work (which meets the requirements in section 217(c) and the regulations thereunder), the loan will be exempt from section 7872 if the following conditions are satisfied:

(A) The conditions contained in paragraphs (c)(1)(i)(A), (B), and (C) of this section;

(B) The loan agreement provides that the loan is payable in full within 15 days after the date of the sale of the employee's immediately former principal residence;

(C) The aggregate principal amount of all outstanding loans described in this paragraph (c)(1)(ii) to an employee is no greater than the employer's reasonable estimate of the amount of the equity of the employee and the employee's spouse in the employee's immediately former principal residence, and

(D) The employee's immediately former principal residence is not converted to business or investment use.

(2) *Below-market loans involving foreign persons*—(i) Section 7872 shall not apply to a below-market loan (other than a compensation-related loan or a corporation-shareholder loan where the borrower is a shareholder that is not a C corporation as defined in section 1361(a)(2)) if the lender is a foreign person and the borrower is a U.S. person unless the interest income imputed to the foreign lender (without regard to this paragraph) would be effectively connected with the conduct of a U.S. trade or business within the meaning of section 864(c) and the regulations thereunder and not exempt from U.S. income taxation under an applicable income tax treaty.

(ii) Section 7872 shall not apply to a below-market loan where both the lender and the borrower are foreign persons unless the interest income imputed to the lender (without regard to this paragraph) would be effectively connected with the conduct of a U.S. trade or business within the meaning of section 864(c) and the regulations thereunder and not exempt from U.S. income taxation under an applicable income tax treaty.

(iii) For purposes of this section, the term "foreign person" means any person that is not a U.S. person.

(3) *Loans without significant tax effect.* Whether a loan will be considered to be a loan the interest arrangements of which have a significant effect on any Federal tax liability of the lender or the borrower will be determined according to all of the facts and circumstances. Among the factors to be considered are—

(i) whether items of income and deduction generated by the loan offset each other;

(ii) the amount of such items;

(iii) the cost to the taxpayer of complying with the provisions of section 7872 if such section were applied; and

(iv) any non-tax reasons for deciding to structure the transaction as a below-market loan rather than a loan with interest at a rate equal to or greater than the applicable Federal rate and a payment by the lender to the borrower.

There is need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under section (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved August 12, 1985

RONALD A. PEARLMAN,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 15, 1985, 12:11 p.m., and published in the issue of the Federal Register for August 20, 1985, 50 F.R. 33519)

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26 CFR 35a.9999-5: Questions and ansers relating to the repeal of 30 percent withholding by section 127 of the Tax Reform Act of 1984 and the application of information reporting and backup withholding in light of such repeal.

Application of the repeal of the 30 percent withholding tax to pass-through certificates. See T.D. 8046, page 61.

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Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions

United States-Netherlands Income Tax Convention, T.D. 5778, 1950-1 C.B. 92; 1956-2 C.B. 1116; and 1965-1 C.B. 624.

Netherlands Antilles; Tax avoidance. The holdings of Revenue Rulings 84-152 and 84-153 will not be applied to interest payments made in connection with debt obligations issued prior to October 15, 1984, and to interest payments made in connection with debt obligations issued on or after October 15, 1984, pursuant to a binding written agreement entered into prior to October 15, 1984. Rev. Ruls. 84-152 and 84-153 modified.

Rev. Rul. 85-163[1]

Rev. Rul. 84-152, 1984-2 C.B. 381, and Rev. Rul. 84-153, 1984-2 C.B. 383, deal with the taxation of interest payments made by United States corporations to Netherlands Antilles corporations.

Pursuant to the authority contained in section 7805(b) of the Internal Revenue Code, the holdings of Rev. Rul. 84-152 and Rev. Rul. 84-153 will not be applied to interest payments made in connection with debt obligations issued prior to October 15, 1984, the date that Rev. Rul. 84-152 and Rev. Rul. 84-153 were published in the Internal Revenue Bulletin and to interest payments made in connection with debt obligations issued on or after October 15, 1984, pursuant to a binding written agreement entered into prior to October 15, 1984, including debt obligations issued on the exercise of a warrant or the conversion of a convertible obligation if such warrant or convertible obligation was issued prior to October 15, 1984.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 84-152 and Rev. Rul. 84-153 are modified.

[1]Also released as News Release IR-85-98, dated September 30, 1985.

Subpart B.—Legislation and Related Committee Reports

Public Law 99-15
99th Congress, H.R. 1866[1]
April 4, 1985

An Act to phase out the Federal supplemental compensation program.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That—

(a) CONTINUATION OF COMPENSATION FOR INDIVIDUALS WHOSE ELIGIBILITY BEGINS PRIOR TO TERMINATION DATE.— Section 602(f)(2) of the Federal Supplemental Compensation Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462, 598, 599] is amended—

(1) by striking out "(2) No Federal" and inserting in lieu thereof "(2)(A) Except as provided in subparagraph (B), no Federal"; and

(2) by adding at the end thereof the following new subparagraph:

"(B) In the case of any individual who is receiving Federal supplemental compensation for the week which includes March 31, 1985, such compensation shall continue to be payable to such individual in accordance with subsection (e) for any week thereafter, in a period of consecutive weeks for each of which he meets the eligibility requirements of this Act."

(b) CONFORMING AMENDMENT TO PERIOD OF ELIGIBILITY.— Section 605(2) of such Act is amended by inserting "(except as otherwise provided in section 602(f)(2)(B))" after "April 1, 1985".

(c) MODIFICATION OF AGREEMENTS.— The Secretary of Labor shall, at the earliest practicable date after the date of the enactment of this Act, propose to each State with which he has in effect an agreement under section 602 of the Federal Supplemental Compensation Act of 1982 a modification of such agreement designed to provide for the payment of Federal supplemental compensation under such Act in accordance with the amendments made by this Act. Notwithstanding any other provision of law, if any State fails or refuses within the three-week period beginning on the date the Secretary of Labor proposes such modification to such State, to enter into such modification of such agreement, the Secretary of Labor shall terminate such agreement effective with the end of the last week which ends on or before the close of such three-week period. Pending modification (or termination) of the agreement, States may pay Federal supplemental compensation in accordance with the amendments made by this Act for weeks beginning after March 31, 1985, and shall be reimbursed in accordance with the provisions of the Federal Supplemental Compensation Act of 1982.

Approved April 4, 1985.

House of Representatives
Report No. 99-36
1st Session

[Bracketed numerals indicate official report page numbers]

April 2, 1985

Mr. Rostenkowski, from the Committee on Ways and Means, submitted the following Report to accompany H.R. 1866.[1]

* * * * *

The Committee on Ways and Means, to whom was referred the bill (H.R. 1866) to phase out the Federal supplemental compensation program, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

* * * * *

I. SUMMARY OF BILL

H.R. 1866 would allow individuals who receive Federal Supplemental Compensation (FSC) for the week of March 31, 1985 through April 6, 1985, the last week of the current program, to continue to receive the remainder of their FSC entitlement.

[1]House Report No 99-36, this page.

[1]Public Law 99-15, this page.

II. EXPLANATION OF BILL

Present Law

The Federal Supplemental Compensation (FSC) program provides 8, 10, 12, or 14 additional weeks of unemployment benefits to unemployed workers who have exhausted their regular State benefits and any Extended Benefits (EB) to which they were entitled (the permanent EB program provides 13 additional weeks of benefits but is triggered on only in Alaska, West Virginia, Idaho, and Puerto Rico).

The number of weeks of FSC payable in a State is based on the State's insured unemployment rate (IUR), a measure of those people in the State claiming regular State unemployment benefits during the most recent 13 week period. States can qualify for the 14 or 12 week tier based on either their current IUR or their average IUR since January 1, 1982. Ten and 8 week tiers are based solely on the current IUR.

The last week for which FSC can be collected is the week ending on Saturday, April 6, 1985. There is no provision in current law for "phasing out" recipients. Benefits cease after the week ending April 6, 1985 regardless of the number of weeks an individual has collected his original entitlement. For the week of March 9, 1985, the most recent week for which data is available, there were 340,000 jobless workers receiving FSC benefits.

H.R. 1866

Under the bill, FSC will be payable for weeks of unemployment beginning after April 6, 1985 only to those people who received FSC for the week of March 31, 1985 through April 6, 1985, the last week of the program under current law. Individuals who receive FSC for that week will be allowed to collect the remainder of their FSC entitlement. Their remaining weeks of benefits must be collected in consecutive weeks.

* * * * *

Public Law 99-44
99th Congress, H.R. 1869[1]

May 24, 1985

An Act to amend the Internal Revenue Code of 1954 to repeal the contemporaneous recordkeeping requirements added by the Tax Reform Act of 1984, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. REPEAL OF CONTEMPORANEOUS RECORDKEEPING REQUIREMENTS, ETC.

(a) CONTEMPORANEOUS RECORDKEEPING REQUIREMENTS.—Subsection (d) of section 274 of the Internal Revenue Code of 1954 (relating to substantiation requirements for certain deductions and credits) is amended by striking out "adequate contemporaneous records" and inserting in lieu thereof "adequate records or by sufficient evidence corroborating the taxpayer's own statement", and the Internal Revenue Code of 1954 shall be applied and administered as if the word "contemporaneous" had not been added to such subsection (d).

(b) PROVISIONS RELATING TO RETURN PREPARES AND NEGLIGENCE PENALTY.—Paragraphs (2) and (3) of section 179(b) of the Tax Reform Act of 1984 are hereby repealed, and the Internal Revenue Code of 1954 shall be applied and administered as if such paragraphs (and the amendments made by such paragraphs) had not been enacted.

(c) REPEAL OF REGULATIONS.—Regulations issued before the date of the enactment of this Act to carry out the amendments made by paragraphs (1)(C), (2), and (3) of section 179(b) of the Tax Reform Act of 1984 shall have no force and effect.

SEC. 2. SUBSTANTIATION REQUIREMENTS NOT TO APPLY TO CERTAIN VEHICLES WITH LITTLE PERSONAL USE

(a) IN GENERAL.—Subsection (d) of section 274 of the Internal Revenue Code of 1954 (relating to substantiation required) is amended by adding at the end thereof the following new sentence: "This subsection shall not apply to any qualified nonpersonal use vehicle (as defined in subsection (i))."

(b) QUALIFIED NONPERSONAL USE VEHICLE DEFINED.—Section 274 of such Code is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) QUALIFIED NONPERSONAL USE VEHICLE.—For purposes of subsection (d), the term 'qualified nonpersonal use vehicle' means any vehicle which, by reason of its nature, is not likely to be used more than a de minimis amount for personal purpose."

SEC. 3. EXEMPTION FROM REQUIRED INCOME TAX WITHHOLDING FOR CERTAIN FRINGE BENEFITS

Section 3402 of the Internal Revenue Code of 1954 (relating to income tax collected at source) is amended by adding at the end thereof the following new subsection:

"(s) EXEMPTION FROM WITHHOLDING FOR ANY VEHICLE FRINGE BENEFIT.—

"(1) EMPLOYER ELECTION NOT TO WITHHOLD.—The employer may elect not to deduct and withhold any tax under this chapter with respect to any vehicle fringe benefit provided to any employee if such employee is notified by the employer of such election (at such time and in such manner as the Secretary shall by regulations prescribe). The preceding sentence shall not apply to any vehicle fringe benefit unless the amount of such benefit is included by the employer on a statement timely furnished under section 6051.

"(2) EMPLOYER MUST FURNISH W-2.—Any vehicle fringe benefit shall be treated as wages from which amounts are required to be deducted and withheld under this chapter for purposes of section 6051.

"(3) VEHICLE FRINGE BENEFIT.—For purposes of this subsection, the term 'vehicle fringe benefit' means any fringe benefit—

"(A) which constitutes wages (as defined in section 3401), and

"(B) which consists of providing a highway motor vehicle for the use of the employee."

SEC. 4. REDUCTION IN LIMITATIONS ON INVESTMENT TAX CREDIT AND DEPRECIATIONS FOR LUXURY AUTOMOBILES.

(a) GENERAL RULE.—

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[1]House Report No. 99-34, page 351; Senate Report No. 99-23, page 357; Conference Report No. 99-67, page 359.

(1) INVESTMENT TAX CREDIT.— paragraph (1) of section 280F(a) of the Internal Revenue Code of 1954 (relating to investment tax credit) is amended by striking out "$1,000" and inserting in lieu thereof "$675".

(2) DEPRECIATION.—Paragraph (2) of section 280F(a) of such Code (relating to depreciation) is amended—

(A) by striking out "$4,000" in subparagraph (A)(i) and inserting in lieu thereof "$3,200", and

(B) by striking out "$6,000" each place it appears in subparagraphs (A)(ii) and (B)(ii) and inserting in lieu thereof "$4,800".

(b) 4-YEAR DEFERRAL OF INFLATION ADJUSTMENT.—

(1) ADJUSTMENT AFTER 1988.—Subparagraph (A) of section 280F(d)(7) of such Code (relating to automobile price inflation adjustment) is amended by striking out "passenger automobile" and inserting in lieu thereof "passenger automobile placed in service after 1988."

(2) 1987 BASE PERIOD.—Subclause (II) of section 280F(d)(7)(B)(i) of such Code is amended by striking out "1983" and inserting in lieu thereof "1987".

(3) TECHNICAL AMENDMENT.—Clause (i) of section 280F(d)(7)(B) of such Code is amended by striking out the last sentence.

SEC. 5. NEW REGULATIONS.

Not later than October 1, 1985, the Secretary of the Treasury or his delegate shall prescribe regulations to carry out the provisions of this Act which shall fully reflect such provisions.

SEC. 6. EFFECTIVE DATES

(a) REPEALS.—The amendment and repeals made by subsections (a) and (b) of section 1 hall take effect as if included in the amendments made by section 179(b) of the Tax Reform Act of 1985 [Pub. L. 98-369, 1984-3.C.B. (Vol. 1) 1, 226].

(b) RESTORATION OF PRIOR LAW FOR 1985.—For taxable years beginning in 1985, section 274(d) of the Internal Revenue Code of 1954 shall apply as it read before the amendments made by section 179(b)(1) of the Tax Reform Act of 1984.

(c) EXCEPTION FROM SUBSTANTIATION REQUIREMENTS FOR QUALIFIED NONPERSONAL USE VEHICLES.—The amendments made by section 2 shall apply to taxable years beginning after December 31, 1985.

(d) WITHHOLDING AMENDMENT.—The amendment made by section 3 shall take effect on January 1, 1985.

(e) REDUCTION IN LIMITATIONS ON INVESTMENT TAX CREDIT AND DEPRECIATION.—

(1) Except as provided in paragraph (2), the amendments made by section 4 shall apply to—

(A) property placed in service after April 2, 1985, in taxable years ending after such date, and

(B) property leased after April 2, 1985, in taxable years ending after such date.

(2) The amendments made by section 4 shall not apply to any property—

(A) acquired by the taxpayer pursuant to a binding contract in effect on April 1, 1985, and at all times thereafter, but only if the property is placed in service before August 1, 1985, or

(B) of which the taxpayer is the lessee, but only if the lease is pursuant to a binding contract in effect on April 1, 1985, and at all times thereafter, and only if the taxpayer first uses such property under the lease before August 1, 1985.

Approved May 24, 1985.

House of Representatives

Report No. 99-34
1st Session

[Bracketed numerals indicate official report page numbers]

REPEAL OF THE CONTEMPORANEOUS RECORDKEEPING REQUIREMENTS

April 2, 1985

Mr. Rostenkowski, from the Committee on Ways and Means, submitted the following Report to accompany H.R. 1869.[1]

The Committee on Ways and Means, to whom was referred the bill (H.R. 1869) to repeal the contemporaneous recordkeeping requirements added by the Tax Reform Act of 1984, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. EXPLANATION OF THE BILL:

A. PRESENT LAW

Substantiation rules

Background

A taxpayer may deduction expenditures, including depreciation and operating costs, attributable to business use of an automobile or other means of transportation. No deduction is allowed for expenditures attributable to the personal use of an automobile or other property (other than for interest on purchase indebtedness or for certain State taxes). For example, the costs of commuting to and from work are personal expenses that are nondeductible pursuant to Code section 262.[1]

Under general tax law principles, the courts have held that a taxpayer bears the burden of proving both the eligibility of an expenditure as a deduction or credit and also the amount of any such [2] eligible expenditure, including the expenses of using a car in the taxpayer's trade or business.[2]

In the Revenue Act of 1962 [Pub. L. 87-834, 1962-3 C.B. 111], the Congress enacted Code section 274(d), under which a taxpayer must substantiate the business purpose, amount, and date of certain types of expenditures "by adequate records or by sufficient evidence corroborating his own statement." This provision was added because the Congress recognized that "in many instances, deductions are obtained by disguising personal expenses as business expenses."[3] These specific substantiation rules were made applicable to (1) traveling expenses (including meals and lodging while away from home); (2) expenditures with respect to entertain-

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[1] Public Law 99-44, page 350.

[1] *Fausner* v. *Commissioner*, 413 U.S. 838 (1973) [1974-2 C.B.42].

[2] See, e.g., *Interstate Transit Lines* v. *Comm'r* 319 U.S. 59, 593 (1943); *Comm'r* v. *Heininger*, 320 U.S. 467 (1943); *Gaines* v. *Comm'r*, 35 T.C.M. 1415 (1976).

[3] H. Rep. No. 87-1447 (March 16, 1962), at 19 [1962-3 C.B. 405, 423].

ment, amusement, or recreation activities or facilities; and (3) business gifts. Local travel expenses were not subject to this provision as enacted, but instead were subject to the general substantiation requirements applicable to all other business expenditures.

1984 Act Amendments

Recordkeeping.—The Tax Reform Act of 1984 (P.L. 98-369) [1984-3 C.B. (Vol. 1) 1] made several amendments to Code section 274(d), effective for taxable years beginning afterr December 31, 1984. First, the 1984 Act added a requirement that the taxpayer must keep "contemporaneous" records to substantiate deductions for expenditures subject to section 274(d). Second, the 1984 Act deleted from section 274(d) the alternative method of substantiating deductions, which was by means of sufficient evidence, (written or oral) corroborating the taxpayer's own statement. Third, the 1984 Act made additional property subject to the requirements of section 274(d), including automobiles and other means of transportation. As a result, local travel expenses, like traveling expenses away from home, became subject to the section 274(d) rules.

Tax prepare rules.—The 1984 Act required that paid income tax return preparers must advise the taxpayer of the section 274(d) substantiation requirements and obtain written confirmation from the taxpayer that these requirements were met. Failure to advise the taxpayer or to obtain the confirmation subjects the return preparer to a penalty of $25 for each failure, unless due to reasonable cause and not to willful neglect (sec. 6695(b)).

Special negligence penalty.—The 1984 Act provided that, for purposes of the section 6653 negligence penalty, any portion of an underpayment of tax due to a failure to comply with the section 274(d) recordkeeping requirements is treated as due to negligence, in the absence of clear and convincing evidence to the contrary. The penalty is five percent of the portion of the understatement attributable to the failure to comply with the section 274(d) recordkeeping requirements (sec. 6653(h)).

Limitations on ITC and depreciation for certain automobiles

General rules

In general, a 6-percent investment tax credit may be claimed for an eligible automobile, and its cost (reduced by one-half the amount of the 6-percent credit) may be recovered over three years. The accelerated recovery percentages, beginning with the first year, are 25, 38, and 37 percent. Other options with respect to the investment credit and depreciation are generally available.

However, limits generally are imposed on the amount of investment credit and annual depreciation deductions that are allowed for an automobile placed in service or leased by the taxpayer after June 18, 1984 (sec. 280F).[4] For an automobile subject to these limits and placed in service in 1984, (1) the investment tax credit is limited to $1,000 (2) depreciation in the first year is limited to $4,000, and (3) depreciation in any subsequent year is limited to $6,000.

For more expensive automobiles, the limits generally produce a recovery period longer than three years. If the depreciation limits result in unrecovered basis existing at the end of the recovery period otherwise applicable, then that basis may be recovered through a depreciation deduction in subsequent years equal to the lesser of the unrecovered basis of $6,000, if use of the automobile in those years is such that a depreciation deduction is otherwise allowable. The "unrecovered basis" means the excess of unadjusted basis over the aggregate amount of depreciation deductions that would have been allowed if 100 perrcent of the automobile's use had been in a trade or business or for the production of income.

The limits for any year are reduced by the proportion of total use in that year that is personal use.

Inflation adjustment to limits

For years after 1984, the $1,000, $4,000, and $6,000 limits are adjusted for inflation, as measured by the percentage growth of the automobile component of the Consumer Price Index for All Urban Consumers between October of the preceding year and October, 1983. The adjustment is rounded to the nearest $100. The adjusted limits for any year apply only to automobiles placed in service in that year.

B. REASONS FOR CHANGE

The contemporaneous recordkeeping requirement and related compliance provisions enacted in the Tax Reform Act of 1984 reflected concerns of the congress about significant overstatements of deductions and credits for claimed business use of automobiles and other types of property that typically are used for personal pur[4]poses, such as for commuting, vacation trips, personal errands and shopping excursions, etc. Many taxpayers who did make business use of automobiles or other vehicles failed to keep fully accurate records or based exaggerated claims of business use on inexact recollections at the time of filing their returns, To achieve increased compliance and accuracy, the Congress required that only contemporaneous records could be used to substantiate traveling expenses and the other types of expenditures listed in section 274(d), as revised by the Act. No definition of "contemporaneous" was set forth in the statute.

As businesses and individuals have sought to understand and comply with the contemporaneous recordkeeping requirement, it has become clear that the requirement sweeps too broadly and generally imposes excessive recordkeeping burdens on may taxpayers. While the Internal Revenue Service has modified its initial regulations and scheduled public hearings prior to adoption of final rules, the committee has concluded that the only appropriate actions that will provide a speedy and certain resolution to these problems are to repeal the "contemporaneous" re-

[4]However, the limits do not apply to (1) certain automobiles acquired under binding contracts in effect before June 19, 1984; (2) ambulances and hearses used directly in the taxpayer's trade or business; (3) vehicles (such as taxicabs and limousines) used by the taxpayer directly in the trade or business of transporting persons or property for compensation or hire; and (4) regulations, trucks or vans

Also, the limits do not apply to an automobile leased or held for leasing by a person regularly engaged in the business of leasing automobiles. Rather, the limitation affects the lessee, whose deductions for lease payments are reduced (according to tables prescribed by the Treasury) by amounts intended to approximate the results of placing the limits on the lessor.

quirement (and the tax return preparer and negligence penalty provisions) as added by the 1984 Act, to repeal the IRS temporary regulations interpreting the "contemporaneous" requirement, to reinstate with modifications generally the prior-law substantiation rules under section 274(d), and to except from these reinstated rules vehicles which, by reason of their nature, are not likely to be used more than a de minimis amount for personal purposes.

To provide guidance to taxpayers, the bill requires the IRS to issue regulations not later than October 1, 1985, carrying out the provisions of the bill. The bill specifies that these IRS regulations must fully reflect all the amendments made by the bill. In addition, IRS regulations must be consistent with the legislative history of the bill, including this report. Accordingly, any type of vehicle (such as farm tractors or combines, marked police or fire vehicles, etc.) that this report specifies are vehicles except from section 274(d) as qualified nonpersonal use vehicles must be so treated in the regulations.

The committee remains concerned about overstated claims of the extent of business use of automobiles or other property. The bill does not repeal all recordkeeping requirements for traveling expenses, etc. Indeed, the bill reinstates the prior-law substantiation requirements of section 274(d) as in effect prior to the 1984 Act amendments, with two modifications. First, a taxpayer who fails to maintain adequate records can substantiate expenditures subject to section 274(d) only by sufficient written evidence corroborating his or her own statement; oral evidence alone is not sufficient as corroboration for this purpose. Second, automobile expenses are made subject to the reinstated section 274(d) substantiation rules, effective for taxable years beginning after 1985; thus, such expenses are treated in the same manner as traveling expenses away from home.

In view of the budget deficit, the committee concluded that it is appropriate to balance the revenue loss resulting from the provisions of the bill repealing certain compliance rules enacted in the 1984 Act by adjusting the limitations set forth in section 280F on [5] the investment tax credit and depreciation deductions for automobiles.

C. EXPLANATION OF PROVISIONS

1. Repeal of 1984 Act provisions

Repeal of "contemporaneous"

The bill repeals the word "contemporaneous" from Code section 274(d) as if it had never been a part of that section. The bill also provides that the Internal Revenue Code is to be applied and administered as if the word "contemporaneous" had never been added to section 274(d).

Repeal of return preparer's provision

The bill repeals the provision of the 1984 Act requiring that a return preparer must specifically advise the taxpayer of the recordkeeping requirements of section 274(d) and must obtain written confirmation from the taxpayer that adequate contemporaneous records existed to support the claimed deductions or credits (Code sec. 6695(b)). The bill provides that the Internal Revenue Code shall be applied and administered as if this provision had never been enacted.

The committee believes that it is inappropriate to single out this one area of recordkeeping for special requirements, since return preparers already are responsible for the overall substantive accuracy of the preparation of the return. Also, because the committee intends (see below) that taxpayers claiming tax credits or depreciation for the use of automobiles and other listed property must indicate on the tax return whether the taxpayer has adequate records or sufficient written evidence supporting the claimed deductions and credits, the return preparer requirement is not needed. That is, if a return preparer signed a return that both claimed a deduction for the business use of a car and indicated that the taxpayer did not have the evidence required by the statute to justify the claims, the return preparer would be subject to existing penalties.

Repeal of special negligence penalty

The bill also repeals the provision of the 1984 Act providing a special negligence penalty rule applicable to an underpayment of tax attrributable to a failure to comply with the recordkeeping requirements of section 274(d). The bill provides that the Internal Revenue Code shall be applied and administered as if this provision had never been enacted.

The committee believes that repealing this portion of the negligence penalty is needed to restore to the Internal Revenue Service and the courts discretion not to impose the negligence penalty for minor, inadvertent recordkeeping or computational errors. The committee emphasizes, however, that the regular negligence and fraud penalties will continue to be applicable if a taxpayer claims tax benefits that cannot be supported. The committee is concerned that these negligence and fraud penalties have not been applied by the Internal Revenue Service or the courts in a substantial number of instances where their application would be fully justified.

[6] In one Tax Court case, for example, the taxpayer had kept detailed mileage records, required by his employer for reimbursement purposes, that indicated that his business use was approximately five percent of total use. On his tax return, the taxpayer claimed 70 percent business use, with no records to justify this claim. The Tax Court properly allowed only five percent business use. The Court did not, however, impose a negligence or fraud penalty. The committee believes that, in a case like this one, the negligence penalty should certainly be imposed, and that careful consideration should be given to imposing the civil fraud penalty.

In another Tax Court case, the taxpayer had kept detailed records so that he could be reimbursed by his employer, but claimed on his tax return approximately 35,000 miles of business use beyond what his records demonstrated, without any justification. No negligence penalty was imposed. In another case, the taxpayer produced a diary purporting to justify the claimed deductions. The Tax Court called the diary a "fabrication" and said that the taxpayer "was not telling the truth." The Court still permitted him a deduction, and did not impose the negligence or civil fraud penalty. Finally, another taxpayer apparently claimed a deduction for business mileage that exceeded the total mileage shown on his odometer, but the Tax Court did not impose a negligence or civil fraud penalty.

These cases indicate that the negligence and civil fraud penalties are not being administered by either the Internal Revenue Service or the courts in the manner that the Congres intended when it initially enacted these penalties. While minor, inadvertent recordkeeping or computational errors should not lead to the imposition of a substantial penalty, the committee believes that it is vital to the integrity of the tax system that honest taxpayers know that others who claim tax benefits far in excess of what can be justified will be subject to the negligence and fraud penalties.

Repeal of regulations

The bill repeals all Treasury Regulations (temporary or proposed) issued prior to the enactment of the bill that carry out the amendments made by section 179(b) of the Tax Reform Act of 1984. Thus, regulations issued to implement the changes to section 274(d) made by that Act, particularly the inclusion in that section of the word "contemporaneous," are revoked.[5] In addition, any regulations relating to the return preparer prrovision and the special negligence penalty (described above) are revoked.[6] These revoked regulations are to have no force and effect whatsoever.[7]

[7] 2. *Definition of adequate records*

In general

The bill amends section 274 to require that taxpayers must maintain adequate records or sufficient written evidence corroborating the taxpayer's own statement to support the credits or deductions they are claiming.

The bill specifies that, in the alternate substantiation test, the sufficient corroborating evidence must be written. The committee believes that it is appropriate to require that taxpayers maintain written evidence to support their claims of tax credits and deductions. The written evidence must exist by the time tax return is filed.[8]

More specifically, in the case of travel, the committee intends that these records or evidence support the deductions or credits claimed. Adequate records or sufficient written evidence includes the following:

a. Account books
b. Diaries
c. Logs
d. Documentary evidence (receipts, paid bills)
e. Trip sheets
f. Expense reports
g. If the employee is required to make an adequate accounting to the employer and the reimbursement equals expenses, the employee is not required to report the expenses and reimbursement on his tax return
h. Written statements of witnesses

All of these types of documentation were specifically approved under prior law. The committee specifically approves of these means of documentation, and considers the longstanding Treasury Regulations on recordkeeping issued under section 274(d)[9] prior to the 1984 Act to reflect accurately its intent as to the documentation that taxpayers are required to maintain, except insofar as those regulations authorize the use of sufficient oral evidence corroborating the taxpayer's own statements and except that the written evidence must be compiled by the time the return is filed. The committee also believes that case law under section 274(d) generally reflects appropriate standards of recordkeeping, except insofar as those cases authorize the use of oral evidence corroborating the taxpayer's own statement. While taxpayers may choose to keep contemporaneous logs on the use of their automobiles, the Treasury is specifically prohibited from requiring that all taxpayers keep daily contemporaneous logs of their use of the automobile.

The committee believes that the written policy statements kept by the employer to implement a policy of no personal use (or no personal use except for commuting) qualify as sufficient written evidence corroborating the taxpayer's own statement. Therefore, the employee will not need to keep records under section 274(d) for [8] the use of vehicle that qualifies under either of these provisions. A written policy statement adopted by a governmental unit would be eligible for this rule. Thus, a resolution of the city council or a provision of state law or the state constitution would qualify, so long as the conditions described below are met.

The committee wants to continue the provision in the recent regulations that provided that no recordkeeping under section 274(d) is required if the employer provides a vehicle to an employee and prohibits personal use by the employee. In order to be eligible for this special rule, the following conditions must be met—

(a) The vehicle owned or leased by the employer is provided to one or more employees for use in connection with the employer's trade or business;

(2) When the vehicle is not being used for such business purposes, it is kept on the employer's business premises (or temporarily located elsewhere, e.g., for repair);

(3) Under the employer's policy, no employee may use the vehicle for personal purposes, other than de minimis personal use (such as a stop for lunch between two business deliveries);

(4) The employer reasonably believes that no employee uses the vehicle, other than de minimis use, for any personal purpose; and

(5) No employee using the vehicle lives at the employer's business premises.

To utilize this exception to the otherwise applicable substantiation requirement, there must be evidence that would enable the Internal Revenue Service to determine whether the use of the vehicle met the five conditions listed in the preceding paragraph.

The committee also wants to continue the provision in the recent regula-

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[5]Also, the regulations prohibiting the employer from including the entire value of the use of the automobile in the income of certain employees are revoked.

[6]The regulations relating to valuation issued under sections 61 and 132 are not, however, revoked.

[7]The committee revokes the regulations that provide for safe harbors for the use of highway vehicles. This change does not prohibit Treasury from developing similar safe harbors. To the extent that Treasury considers reinstating these safe harbors, the committee believes that Treasury should consider whether the standard requiring that farmers derive 70% of their income from farming may be too high.

[8]In a few instances, the courts had permitted taxpayers to deduct amounts solely on the basis of oral evidence. The committee believes that requiring written evidence will be beneficial to taxpayers, because they will compile the necessary information by the time the tax return is filed.

[9]See Treas. Reg. sec. 1.274-5, initially published in the *Federal Register* on December 29, 1962.

tions that provided that no recordkeeping under section 274(d) is required if the employer provides a vehicle to a specified employee and prohibits personal use by the employee, except for commuting. In order to be eligible for this rule, the following conditions must be met—

(1) The vehicle owned or leased by the employer is provided to one or more employees for use in connection with the employer's trade or business and is used in the employer's trade or business;

(2) For bona fide noncompensatory business reasons, the employer requires the employee to commute to and/or from work in the vehicle;

(3) The employer establishes a policy under which the employee may not use the vehicle for personal purposes, other than commuting or de minimis personal use (such as a stop for a personal errand between a business delivery and the employee's home);

(4) The employer reasonable believes that, except for de minimis use, the employee does not use the vehicle for any personal purpose other than commuting; and

(5) The employer accounts for the commuting use by including an appropriate amount in the employee's gross income. This special exception to the substantiation rule is not available if the employee using the vehicle for commuting is an officer or one-percent owner of the employer.

[9] In order to utilize this exception to the otherwise applicable substantiation requirements, there must be evidence that would enable the Internal Revenue Service to determine whether the use of the vehicle meets the conditions set forth in the preceding paragraphs.

Information required on return

The committee wants to ensure that taxpayers claim only the deductions to which they are entitled without being unduly burdened by complex recordkeeping requirements. The committee also believes that taxpayers should provide sufficient information on their returns so that the Internal Revenue Service can make a preliminary evaluation of the appropriateness of the taxpayer's claimed deductions. Previously, the Internal Revenue Service found it difficult to make this sort of preliminary evaluation without auditing the taxpayer, which can also be a significant burden on the taxpayer. Therefore, the committee believes that taxpayers should all answer a few short questions on their returns if they claim the tax benefits for the business use of an automobile.

The committee believes that taxpayers will not be significantly burdened by responding to a few questions, most of them requiring a yes or no response. The committee directs that the following questions appear on the tax return, to be answered by taxpayers claiming credits or deductions for the business use of an automobile:

1. Total number of miles driven during the year: miles.

2. Percentage of personal use claimed: %.

3. Was the vehicle used for commuting Yes No. If Yes, the distance normally commuted: miles.

4. Was the vehicle available for personal use in off duty hours Yes No.

5. Is another vehicle available for personal use Yes No.

6. I have adequate records or sufficient written evidence to justify these deductions Yes No. If no, no deduction is permitted.

The committee notes that the requirement that these questions be included on the tax forms does not appear in the bill because the Internal Revenue Code does not generally specify the format or specific content of forms. The Internal Revenue Code does not need to be amended to provide the authority to require these questions, since that authority already exists in sections 6001 and 6011.

The committee intends that employees who claim deductions or credits for business use of their own car be asked these questions on Form 2106 (relating to employee business expenses); some of this information is already required to be provided on that form. Unincorporated taxpayers who claim these credits or deductions on either Schedules C or F (or on some other form) will be asked these questions on that form. Corporate taxpayers, as well as all other taxpayers and entities, will be asked these questions on the forms they are required to file.

The committee intends that employees give this information to their employers if the employer provided the car. Generally, the [10] employer would put this information on its tax return, since the employer is claiming the tax benefits of the use of the car. Employers who provide more than 5 cars to employees, however, would not have to include this information on the employer's return; the Internal Revenue Service could examine on audit the information that the employees provide to the employer. The employer would have to indicate on his return that he has received this information from the employees. The employer can rely on the employee's statement (unless the employer has reason to know it is false) to determine the credits and deductions to which the employer is entitled and to determine the amount of income, if any, the employer must include in the employee's income because of the employee's personal use of the employer's car.

The committee intends that similar questions be asked on the tax return about other listed property, such as yachts, airplanes, and computers. For computers, for example, the following questions should be asked:

1. Percentage of personal use claimed: %.

2. Was the computer located at your place of business or your home or both. If both, what percentage of the year was it at home: %.

3. Do you have records or written evidence to justify these deductions Yes No.

3. Vehicles with no personal use

The bill provides that any vehicle that by reason of its nature is not likely to be used more than a de minimis amount for personal purposes is exempt from the recordkeeping requirements of section 274(d).

The committee believes that this is an appropriate exemption from the recordkeeping requirements of section 274(d) because one of the purposes of those recordkeeping requirements is to ensure that taxpayers do not deduct as a business expense an expense that is really personal in nature. This purpose does not apply to a vehicle the charac-

teristics of which make it highly unlikely that it will be used more than a very minimal amount for personal purposes. Consequently, the committee believes that it is appropriate to exempt these vehicles from the recordkeeping requirements of section 274(d). Taxpayers will still have to justify their claimed deductions for these vehicles as required under either section 162 or 212, which are the general provisions relating to business deductions.

The Internal Revenue Service had listed in its recent regulations under section 274(d) several examples of vehicles that by their nature are not likely to be used more than a de minimis amount for personal purposes:

a. forklifts,

b. cement mixers,

c. dump trucks (including garbage trucks),

d. refrigerated trucks,

e. tractors, and

f. combines.

The committee intends that these types of vehicles continue to be considered to be not susceptible to personal use. In addition, the committee believes that there are other types of vehicles that, be- [11] cause of their inherent nature or characteristics, are unlikely to be used more than a very minimal amount for personal purposes. The committee has identified the following types of vehicles as meeting this criterion:

a. delivery trucks with seating only for the driver,[10]

b. flatbed trucks,

c. any vehicle designed to carry cargo with a loaded gross vehicle weight over 14,000 pounds,

d. passenger buses used as such with a capacity of at least 20 passengers,

e. clearly marked police and fire vehicles,

f. ambulances used as such,

g. hearses used as such,

h. bucket trucks ("cherry pickers"),

i. cranes, and

j. derricks.

The committee recognizes that it may not have developed an exhaustive list of vehicles not susceptible to personal use. Therefore, the committee intends that the Internal Revenue Service expand this list through either regulations or revenue rulings to include those vehicles that the committee may not have included in this listing but that are appropriate for listing because by their nature it is highly unlikely that they will be used more than a very minimal amount for personal purposes.

A clearly marked police or fire vehicle, owned or leased by a governmental unit that is clearly marked (through painted insignia or words) as a police or fire vehicle, the markings on which make it readily apparent that it is a police or fire vehicle. A marking on a license plate is not a clear marking.

The committee expects that it is appropriate for Treasury to provide in regulations that under certain conditions all use of such vehicles by an employee is excluded, as a working condition fringe benefit, from the employee's income and wages. If, for example, an employer requires, for bona fide business reasons, that the employee takes such a vehicle to his or her home when the employee is not working and that no personal use (e.g., shopping or recreation) is made of the vehicle, then all use of the vehicle could be considered business use which would be deductible under section 162, and thus excluded from income under section 132(d) as a working condition fringe.

The committee has not generally exempted from the recordkeeping requirement all pickup trucks and vans, because these vehicles can be easily used for personal purposes. Some taxpayers purchase these vehicles as substitutes for passenger sedans, and use them predominantly (or entirely) for personal purposes. One article has noted that, should vans be exempted, "taxpayers will have an opportunity to acquire luxury passenger vehicles with full tax benefits." On the other hand, however, the committee recognizes that this is not applicable to all vans. For example, a van that has only a front bench for seating, in which permanent shelving has been [12] installed, that constantly carries merchandise, and that has been specially painted with advertising or the company's name, is a vehicle not susceptible to personal use.

4. Withholding elections

As authorized by the legislative history of the 1984 Act, the Internal Revenue Service has provided (in temporary regulations) that an employer may withhold income and employment taxes due on taxable fringe benefits provided to an employee on a quarterly basis. For example, if the employee receives a $100 taxable benefit on January 10, withholding can be deferred by treating the benefit as paid on March 31.

The committee intends that the regulations are to be revised to allow an employer to elect, for income and employment tax purposes, to treat taxable fringe benefits (including personal use of employer-provided automobiles) as paid on a pay period, quarterly, semi-annual, or annual basis. Thus, in the example above, withholding could be deferred by treating the benefit as paid on June 30 or December 31.

In addition, the bill provides that an employer could elect not to withhold income taxes on the value of the personal use of an automobile that is included in the employee's income if (1) the employer gives the employee advance written notice of this election that nonwithholding is implemented as to that employee and (2) the employer includes the taxable amount of the benefit in the employee's income as reported on the Form W-2 provided by the employer to the employee for the year in which such benefit is received.[11] This generally must be provided to the employee by January 1 of the year as to which the election is to apply; if an election is made for 1985, the notice must be provided by July 1, 1985. If the employer elects not to withhold income taxes, the employee can increase his withholding from regular wages by adjusting his Form W-4 so that the employee does not need to make estimated tax payments.

5. Limitations on ITC and depreciation

The bill reduces the limits on the amount of investment tax credit and annual depreciation deductions that are allowed for an automobile as follows: (1) the investment tax credit is limited to $675; (2) depreciation on the first year is limited to $3600; and (3) depreciation in any subsequent year is limited to $5400.

[10] A vehicle with a jump seat (i.e., a seat that folds up flat) in addition to the seat only for the driver would also qualify.

[11] These amounts will be treated as withheld upon for purposes of 280F(d)(6)(C)(i)(III).

For years after 1985, the limits provided in the bill are indexed for inflation, as measured by the percentage growth of the automobile component of the consumer Price Index for All Urban Consumers between October of the preceding year and October 1984. Adjustments for inflation are otherwise determined as under present law. The committee intends that the Secretary of the Treasury shall prescribe the adjusted limits.

[13] D. EFFECTIVE DATES

Substantiation rules

The repeal of word "contemporaneous" from section 274(d) and the repeal of the return preparer's provision and the special negligence penalty enacted in the 1984 Act are effective as if those provisions had never been included in the 1984 Act.

The amendments to section 274(d) as reinstated—(1) providing that the evidence which can corroborate the taxpayer's own statement, in the absence of adequate records, is written evidence and (2) modifying the types of items subject to section 274(d)—are effective for taxable years beginning after December 31, 1985. The Internal Revenue Service is required to issue the regulations carrying out the provisions of the bill no later than October 1, 1985. This should give taxpayers sufficient time to prepare to comply with the provisions of this bill.

For taxable years beginning in 1985, the bill provides that prior law relating to recordkeeping applies. The committee believes that, because of the confusion that has existed since the start of the current year as to what recordkeeping requirements taxpayers would have to follow, taxpayers should be permitted for the current year to follow the rules that were in effect before the 1984 Act.

Limitations on ITC and depreciation

In general, the reduced limits on the investment tax credit and depreciation are effective for property placed in service by the taxpayer or leased by the taxpayer after April 2, 1985. However, property acquired by the taxpayer pursuant to a binding contract in effect on April 1, 1985, and at all times thereafter, is not subject to the reduced limits provided by the bill, if it is placed in service before August 1, 1985; and property of which the taxpayer is the lessee pursuant to a binding contract in effect on April 1, 1985, and all times thereafter, is not subject to the reduced limits if the taxpayer first uses the property under the lease before August 1, 1985. The reduced limits on the investment tax credit and depreciation are effective for the remainder of 1985; in 1986, those limits are indexed.

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Senate Report No. 99-23
1st Session

[Bracketed numerals indicate official report page numbers]

REPEALING THE REQUIREMENT THAT CONTEMPORANEOUS RECORDS BE KEPT TO SUBSTANTIATE CERTAIN DEDUCTIONS AND CREDITS

April 2 (legislative day, February 18), 1985.

Mr. Packwood, from the Committee on Finance, submitted the following Report to accompany S. 245.[1]

* * * * *

The Committee on Finance, to which was referred the bill (S. 245) to repeal the requirement that contemporaneous records be kept to substantiate certain deductions and credits, having considered the same, reports favorably thereon with an amendment to the text and an amendment to the title and recommends that the bill as amended do pass.

The amendment to the text of the bill is shown in italics.

[2] I. EXPLANATION OF THE BILL

A. PRESENT LAW

Substantiation rules

Background

A taxpayer may deduct expenditures, including depreciation and operating costs, attributable to business use of an automobile or other means of transportation. No deduction is allowed for expenditures attributable to the personal use of an automobile or other property (other than for interest on purchase indebtedness or for certain State taxes). For example, the costs of commuting to and from work are personal expenses that are nondeductible pursuant to Code section 262.[1]

Under general tax law principles, the courts have held that a taxpayer bears the burden of proving both the eligibility of an expenditure as a deduction or credit and also the amount of any such eligible expenditure, including the expenses of using a car in the taxpayer's trade or business.[2]

In the Revenue Act of 1962 [Pub. L. 87-834, 1962-3 C.B. 111], the Congress enacted Code section 274(d), under which a taxpayer must substantiate the business purpose, amount, and date of certain types of expenditures "by adequate records or by sufficient evidence corroborating his own statement." This provision was added because the Congress recognized that "in many instances deductions are obtained by disguising personal expenses as business expenses."[3] These specific substantiation rules were made applicable to (1) traveling expenses (including meals and lodging while away from home); (2) expenditures with respect to entertainment, amusement, or recreation activities or facilities; and (3) business gifts. Local travel expenses were not subject to this provision as enacted, but instead were subject to the general substantiation requirements applicable to all other business expenditures.

1984 Act amendments

Recordkeeping.—The Tax Reform Act of 1984 (P.L. 98-369) [1984-3 C.B. (Vol. 1) 1] made several amendments to Code section 274(d), effective for taxable years beginning after December 31, 1984. First, the 1984 Act added a requirement that the taxpayer must keep "contemporaneous" records to substantiate deductions for expenditures subject to section 274(d). Second, the 1984 Act deleted from section 274(d) the alternative method of substantiating deductions, which was by means of sufficient evidence (written or oral) corroborating the taxpayer's

[1] Public Law 99-44, page 350.

[1] *Fausner* v. *Comm'r* 413 U.S. 838 (1973) [1974-2 C.B. 42].

[2] See, e.g., *Interstate Transit Lines* v. *Comm'r* 319 U.S. 59, 593 (1943); *Comm'r* v. *Heininger*, 320 U.S. 467 (1943); *Gaines* v. *Comm'r*, 35 T.C.M. 1415 (1976).

[3] H. Rept. No. 87-1447, 87th Cong., 2d sess. (1962), at 19 [1962-3 C.B. 405, 423].

own statement. Third, the 1984 Act made additional property subject to the requirements of section 274(d), including automobiles and other means of transportation. As a result, local travel expenses, like traveling expenses away from home, becoem subject to the section 274(d) rules.

[3] *Tax preparer rules.*—The 1984 Act required that paid income tax return preparers must advise the taxpayer of the section 274(d) substantiation requirements and obtain written confirmation from the taxpayer that these requirements were met. Failure to advise the taxpayer or to obtain the confirmation subjects the return prepaper to a penalty of $25 for each failure, unless due to reasonable cause and not to willful neglect (sec. 6695(b)).

Special negligence penalty.—The 1984 Act provided that, for purposes of the section 6653 negligence penalty, any portion of an underpayment of tax due to a failure to comply with the section 274(d) recordkeeping requirements is treated as due to negligence, in the absence of clear and convincing evidence to the contrary. The penalty is five percent of the portion of the understatement attributable to the failure to comply with the section 274(d) recordkeeping requirements (sec. 6653(h)).

B. REASONS FOR CHANGE

The contemporaneous recordkeeping requirement and related compliance provisions enacted in the Tax Reform Act of 1984 reflected concerns of the Congress about significant overstatements of deductions and credits for claimed business use of automobiles and other types of property that typically are used for personal purposes, such as for commuting, vacation trips, personal errands and shopping excursions, etc. Many taxpayers who did make business use of automobiles or other vehicles failed to keep fully accurate records or based exaggerated claims of business use on inexact recollections at the time of filing their returns. To achieve increased compliance and accuracy, the Congress required that only contemporaneous records could be used to substantiate traveling expenses and the other types of expenditures listed in seciton 274(d), as revised by the 1984 Act. No definition of "contemporaneous" was set forth in the statute.

As businesses and individuals have sought to understand and comply with the contemporaneous recordkeeping requirement, it has become clear that the requirement sweeps too broadly and generally imposes excessive recordkeeping burdens on many taxpayers. While the Internal Revenue Service has modified its initial regulations interpreting the new requirement and has scheduled public hearings prior to adoption of final rules, the committee has concluded that the only appropriate actions that will provide a speedy and certain resolution to these problems are to repeal the "contemporaneous" requirement (and the tax return preparer and negligence penalty provisions) as added by the 1984 Act, to repeal the IRS temporary regulations interpreting the "contemporaneous" requirement, and to reinstate the prior-law substantiation standards under section 274(d) and the long-standing regulations thereunder.

[4] C. EXPANATION OF PROVISIONS

1. Repeal of 1984 Act provisions

Repeal of "contemporaneous"

The bill strikes the words "adequate contemporaneous records" from Code section 274(d) as if those words had never been a part of that provision, and inserts in lieu thereof the words "adequate records or by sufficient evidence corroborating the taxpayer's own statement". This is the substantiation standard that had been in effect prior to the Tax Reform Act of 1984 and that had been interpreted in long-standing IRS regulations originally issued in 1962.

The substantiation standard reinstated by the bill applies, as provided by section 274(d), to traveling expenses; entertainment, amusement, or recreation activities or facilities; business gifts; and, effective for taxable years beginning after 1984, and listed property (as defined in sec. 280F(d)(4)).

Repeal of return preparer provision

The bill repeals the provision of the 1984 Act requiring that a return preparer must specifically advise the taxpayer of the recordkeeping requirements of section 274(d) and must obtain written confirmation from the taxpayer that such requirements wer
met (Code sec. 6695(b)). The bill pro
vides that the Internal Revenue Cod
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this provision had never been enacted

Repeal of special negligence penalt

The bill repeals the provision o
1984 Act providing a special negli
gence penalty rule (Code sec. 6653(h)
applicable to an underpayment of ta
attributable to a failure to comply wit
the recordkeeping requirements of sec
tion 274(d). The bill provides that th
Internal Revenue Code shall be applie
and administered as if this provisio
had never been enacted.

Repeal of certain regulations

The bill repeals all Treasury regula
tions (temporary or proposed) issue
prior to the enactment of the bill whic
carry out the amendments made by pa
agraphs (1)(C), (2), and (3) of sectio
179(b) of the Tax Reform Act of 198
that are repealed by this bill. These r
voked regulations are to have no forc
and effect whatsoever.

2. Limited-use vehicles and certain flight benefits

The committee intends that Treasur
regulations are to provide that the fai
market value of an employee'
commuting use of a limited-use vehicl
furnished by the employer is excluded
as a working condition fringe, from th
employee's gross income for Federa
income tax purposes, and from th
wage base (and, if applicable, from th
benefit base) for purposes of incom
tax withholding and FICA, FUTA, an
RRTA taxes. A limited-use vehicle is
vehicle the characteristics of whic
make it unlikely that it will be use
more than a very minimal amount fo
personal purposes. Example of suc
limited-use vehicles include marked po
lice and fire vehicles, ambulances use
as such, school buses used as such
dump [5] trucks, cement mixers, refri
erated trucks, tractors, and specialize
utility repair trucks used as such.

The committee also intends that th
Treasury is to substitute the followin
safe-harbor valuation rules with respe
to employee flights on employe
provided noncommercial aircraft th
constitute taxable fringe benefits, f
the valuation rules with respect to su
benefits that are currently set forth

temporary regulations. The committee believes that these substitute safe-harbor rules reflect the intent of the Congress concerning the valuation of personal use of noncommercial aircraft under the fringe benefit rules in the Tax Reform Act of 1984.

Weight of aircraft	Includible value for control employees	Includible value for other employees
More than 10,000 pounds	First class fare	Value imputed to parent of airline employee.
More than 6,000 pounds but not more than 10,000 pounds.	Coach fare	¾ value imputed to parent of airline employee.
6,000 pounds or less	½ coach fare	½ value imputed to parent of airline employee.

The amount imputed to employees other than control employees is intended to be no more than the amount imputed to a parent of an airline employee, since it is difficult to distinguish the value of a standby flight on a commercial airline and a flight on a space-available basis on a similar noncommercial jet aircraft. However, the amount imputed to a parent of an airline employee under temporary Treasury regulations is presently 50 percent of the highest unrestricted coach fare for the trip which is charged by the carrier for which the employee works. The safe-harbor valuation regulations (as revised to reflect the committee's intent) are to utilize rules referring to commercial airline fares, such as Standard Initial Fare Level (SIFL) rates or industry average rates.

For purposes of the valuation rules in the table above, the term control employee means an employee (whether or not an officer) who controls the use of the aircraft for the trip, i.e., who controls either the use, scheduling, or destination of the aircraft.

D. EFFECTIVE DATE

The provisions of the bill repealing certain provisions enacted in the tax Reform Act of 1984 take effect as if included in the amendments made by section 179(b) of the 1984 Act.

* * * * *

Conference Report No. 99-67
1st Session

[Bracketed numerals indicate official report page numbers]

REPEAL OF CONTEMPORANEOUS RECORDKEEPING REQUIREMENTS

May 7, 1985

Mr. Rostenkowski, from the committee of conference, submitted the following conference report to accompany H.R. 1869.[1]

* * * * *

JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two houses on the amendments of the Senate to the bill (H.R. 1869) to repeal the contemporaneous recordkeeping requirements added by the Tax Reform Act of 1984, and for other purposes, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

The Senate amendment to the text of the bill struck out all of the House bill after the enacting clause and inserted a substitute text.

The House recedes from its disagreement to the amendment of the Senate with an amendment which is a substitute for the house bill and the Senate amendment. The differences between the House bill, the Senate amendment, and the substitute agreed to in conference are noted below, except for clerical corrections, conforming changes made necessary by agreements reached by the conferees, and minor drafting and clarifying changes.

* * * * *

[1]Public Law 99-44, page 350.

[5] STATEMENT OF MANAGERS ON THE PART OF THE HOUSE

I. EXPLANATION OF PROVISIONS

A. Repeal of Requirement that Certain Records Must Be Contemporaneous (secs. 1(a) and (c) and 2(a) of the House bill and secs. 1(a) and (c) of the Senate amendment)

1. Repeal of "contemporaneous" requirement

Present law

The Tax Reform Act of 1984 (the 1984 Act) [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1] amended Code section 274(d) to require that taxpayers must maintain "adequate contemporaneous records" to substantiate deductions and credits for business use of automobiles and other listed property.

House bill

The House bill repeals the word "contemporaneous," effective as if it had never been enacted.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

2. Alternate substantiation method

Present law and background

Prior to the 1984 Act, taxpayers were required under section 274(d) to substantiate deductions for travel away from home (including meals and lodging), for items with respect to entertainment, amusement, or recreation activities of facilities, and for business

gifts by adequate records or by sufficient evidence corroborating the taxpayer's own statement. In the case of an expense or item subject to substantiation under section 274(d), that provision required substantiation as to (1) the amount of such expense or other item, (2) the time and place of the travel, entertainment, amusement, recreation, or use of the facility, or the date and description of the gift, (3) the business purpose of the expense or other item, and (4) the business relationship to the taxpayer of persons entertained, using the facility, or receiving the gift. Prior to the 1984 Act, local travel (i.e., travel not away from home) was not subject to the section 274(d) substantiation standards.

Section 179(b) of the 1984 Act deleted from section 274(d) the alternate substantiation method of sufficient evidence corroborating the taxpayer's own statement. The 1984 Act also applied the section 274(d) substantiation requirements to deductions or credits claimed for use of listed property (as defined in sec. 280F(d)(4)). The categories of listed property include automobiles (whether used for local travel or travel away from home), other means of transportation, computers, etc.

[6] *House bill*

The House bill provides that, as an alternative to maintaining adequate records, taxpayers may substantiate deductions and credits under section 274(d) by sufficient written evidence corroborating their own statement.

The committee report also requires that certain information concerning mileage and business use of vehicles, as well as similar information concerning business use of other listed property, must be requested on tax returns.

The House bill is effective on January 1, 1986. For 1985, the substantiation rules in effect prior to the 1984 Act would apply.

Senate amendment

The Senate amendment is similar to the House bill in that it provides for an alternate substantiation method. However, the Senate amendment does not require that the evidence must be written in order to qualify as sufficient under the alternate substantiation standard. The Senate amendment is effective January 1, 1985.

The Senate amendment does not specifically require that questions regarding the business use of automobiles and other listed property be asked on tax returns.

Conference agreement

Substantiation standards

In general

The conference agreement generally follows the Senate amendment as to the substantiation standards under section 274(d). Thus, section 274(d) is amended to require that a taxpayer must have adequate records or sufficient evidence corroborating the taxpayer's own statement to support credits or deductions for expenditures subject to the section 274(d) substantiation rules. As under pre-1984 Act law section 274(d) as amended by the bill requires the taxpayer to substantiate (1) the amount of the expense or item subject to section 274(d), (2) the time and place of the travel, entertainment, amusement, recreation, or use of the facility or property, or the date and description of the gift, (3) the business purpose of the expense or other item, and (4) the business relationship to the taxpayer of persons entertained, using the facility or property, or receiving the gift.

The conferees believe that a taxpayer's uncorroborated statement as to the business use of an automobile or other listed property does not alone have sufficient probative value to warrant consideration by the Internal Revenue Service or the courts. Consequently, the conferees adopt for this purpose the standard of prior law applicable to travel away from home and business entertainment (sec. 274(d)) that requires taxpayers to provide either adequate records or sufficient evidence corroborating their own statements in order to support a deduction or credit under section 274(d). The more general substantiation standards applicable under section [7] 162,[1] which have been interpreted to permit in certain circumstances uncorroborated statements by taxpayers to support business deductions not subject to section 274(d) or other special rules, are to have no application to deductions or credits with respect to local travel, computers, and other listed property first required (under this bill) to meet the section 274(d) substantiation standards beginning January 1, 1986, just as they are to have no application with respect to expenditures with respect to travel away from home, etc., which continue to be subject to section 274(d) substantiation standards.

The conference agreement does not include the provision of the House bill that would require that the sufficient evidence corroborating the taxpayer's own statement be written. The conferees believe that oral evidence corroborating the taxpayer's own statement, such as oral testimony from a disinterested, unrelated party describing the taxpayer's activities, may be of sufficient probative value that it should not be automatically excluded from consideration under section 274(d).

The conferees emphasize, however, that different types of evidence have different degrees of probative value. The conferees believe that oral evidence alone has considerably less probative value than written evidence. In addition, the conferees believe that the probative value of written evidence is greater the closer in time it relates to the expenditure. Thus, written evidence arising at or near the time of the expenditure, absent unusual circumstances, has much more probative value than evidence created years later, such as written evidence first prepared for audit or court.

The conferees specifically approve the types of substantiation that were required under prior law, and consider the longstanding Treasury regulations on recordkeeping issued under section 274(d)[2] prior to the 1984 Act to reflect accurately their intent as to the substantiation that taxpayers are required to maintain.[3] While taxpayers may choose

[1] Under general tax law principles, the courts have held that a taxpayer bears the burden of proving both the eligibility of any expenditure claimed as a deduction or credit and also the amount of any such eligible expenditure, including the expenses of using a car in the taxpayer's trade or business. See, e.g., *Interstate Transit Lines* v. *Comm'r*, 319 U.S. 590, 593 (1943); *Comm'r* v. *Heininger*, 320 U.S. 467 (1943); *Gaines* v. *Comm'r*, 35 T.C.M. 1415 (1976).

[2] See Treas. Reg. sec. 1.274-5.

[3] Prior law provided that adequate records or sufficient evidence may take the following forms:

a. Account books
b. Diaries
c. Logs

to keep logs on the use of their automobiles, and while such evidence generally has more probative value than evidence developed later, the Treasury is specifically prohibited from requiring that taxpayers keep daily contemporaneous logs of their use of automobiles.

[8] The conferees expect the Internal Revenue Service and the courts to continue to weigh carefully the probative value of these, as well as all other, forms of evidence. The Service and the courts continue to have the ability to discount or reject totally evidence that has limited or no probative value (such as documents actually created much later than they purport to have been created). As noted above, section 274(d) requires that the records or evidence (whatever their particular form) most substantiate not just the amount of the expense, but also the time and place of the travel, entertainment, amusement, recreation, or use of the facility or property, or the date and description of the gift; the business purpose of the expense or other item; and the business relationship to the taxpayer of persons entertained, using the facility or property, or receiving the gift.

Although the conferees intend that the principles of these regulations fully apply to deductions and credits claimed for local travel and the use of other listed property under section 274(d), the conferees also recognize that these principles will need to be carefully applied to local travel and listed property not previously subject to section 274(d). This will need to be done because the nature of making these expenditures generally differs from the nature of making the types of expenditures that had been required to meet the section 274(d) substantiation standards prior to the 1984 Act, such as travel away from home and business meals. For example, deductions associated with local travel may be for annual amounts for items such as depreciation and insurance, rather than a series of discrete expenditures for meals or hotels. Also, expense for travel away from home often involve a third party, such as an airline, train, or hotel, that provides a receipt for the taxpayer of the date and amount of the expenditure and the destination or location. Similarly, expenses for business meals generally occur in restaurants, which provide a similar receipt. While these receipts do not, of course, encompass all of the elements of the substantiation requirements under section 274(d),[4] they do aid taxpayers in their recordkeeping. Similar third party involvement generally is not available for local travel or the use of computers. Similarly, expenses for travel away from home or for business meals do not generally occur with the same frequency as individual local travel trips. Because the bill repeals the 1984 Act requirement of contemporaneous records, taxpayers are not required to maintain trip-by-trip logs and records encompassing each element of the substantiation standards of section 274(d) to justify a deduction or credit.

Consequently, the conferees recognize that some adjustment generally will need to be made in order to apply these principles to the specific factual circumstances surrounding expenditures for local travel and use of listed property not previously subject to section 274(d) rules. The conferees believe that the courts and the Treasury can make these required adjustments without sacrificing these principles, and without reverting to the section 162 standards (including the *Cohan*[5] rule), which the conferees have determined are [9] inadequate and unacceptable for purposes of section 274(d). In several cases previously decided under section 274(d), it is not clear that the courts had rejected the *Cohan* rule; the conferees believe that the courts must clearly and explicitly reject the *Cohan* rule for expenditures required to meet the substantiation requirements of section 274(d).

Written policy statements

The conferees intend that the two types of written policy statements satisfying the conditions described below, if initiated and kept by an employer to implement a policy of no personal use (or no personal use except for commuting) of a vehicle provided by the employer, qualify as sufficient evidence corroborating the taxpayer's own statement[6] and therefore will satisfy the employer's substantiation requirements under section 274(d). Therefore, the employee need not keep a separate set of records for purposes of the employer's substantiation requirements under section 274(d) with respect to use of a vehicle satisfying these written policy statement rules. A written policy statement adopted by a government unit as to employee use of its vehicles would be eligible for these exceptions to the section 274(d) substantiation rules. Thus, a resolution of a city council or a provision of state law or the state constitution would qualify as a written policy statement, so long as the conditions described below are met.

The first type of written policy statement that will satisfy the employer's substantiation requirements under section 274(d) is a policy that prohibits personal use by the employee. In order to be eligible for this special rule, all of the following conditions must be met—

(1) The vehicle is owned or leased by the employer and is provided to one or more employees for use in connection with the employer's trade or business;

(2) When the vehicle is not being used for such business purposes, it is kept on the employer's business premises (or temporarily located elsewhere, e.g., for repair);

(3) Under the employer's written policy, no employee may use the vehicle for personal purposes, other than de minimis, personal use (such as a stop for lunch between two business deliveries);

d. Documentary evidence (receipts, paid bills)
e. Trip sheets
f. Expense reports
g. Statements of witnesses
h. If the employee is required to make an adequate accounting to the employer and the reimbursement equals expenses, the employee is not required to report the expenses and reimbursement on his or her tax return. (A reimbursement would equal expenses where the reimbursement is determined pursuant to data on the type of automobile and its availability for personal purposes, and on a reasonable allocation of local operating and fixed costs.)

[4]For example, the third party is not in a position to record the business purpose of the trip or meal; the taxpayer must provide that information, which is required under the section 274(d) substantiation rules.

[5]*Cohan* v. *Commissioner*, 39 F.2d 540, 544 (2d Cir. 1930).

[6]The substance of these two special rules was set forth in the temporary Treasury regulations repealed by the bill. The conferees intend that these rules, as described in this report, be reinstated in the new regulations required by the bill.

(4) The employer reasonably believes that no employee uses the vehicle, other than de minimis use, for any personal purpose;

(5) No employee using the vehicle lives at the employer's business premises; and

(6) There must be evidence that would enable the Internal Revenue Service to determine whether the use of the vehicle met the five preceeding conditions.

The second type of written policy statement that will satisfy the employer's substantiation requirements under section 274(d) is a policy that prohibits personal use by the employee, except for commuting. In order to be eligible for this rule, all of the following conditions must be met—

[10] (1) The vehicle is owned or leased by the employer and is provided to one or more employees for use in connection with the employer's trade or business and is used in the employer's trade or business;

(2) For bona fide noncompensatory business reasons, the employer requires the employee to commute to and/or from work in the vehicle;

(3) The employer establishes a written policy under which the employee may not use the vehicle for personal purposes, other than commuting or de minimis personal use (such as a stop for a personal errand between a business delivery and the employee's home);

(4) The employer reasonably believes that, except for de minimis use, the employee does not use the vehicle for any personal purpose other than commuting;

(5) The employer accounts for the commuting use by including an appropriate amount (specified in Treasury regulations) in the employee's gross income;[7] and

(6) There must be evidence that would enable the Internal Revenue Service to determine whether the use of the vehicle met the five preceding conditions.

This second type of written policy statement is not available if the employee using the vehicle for commuting is an officer or one-percent owner of the employer.[8]

Tax return questions

The conference agreement generally follows the House bill as to information to be requested on tax returns about business use of vehicles and other listed property.

The conferees want to ensure that taxpayers claim only the deductions and credits to which they are entitled, but without being unduly burdened by unnecessarily complex recordkeeping requirements. At the same time, the conferees believe that taxpayers should provide sufficient information on their returns so that the Internal Revenue Service can make a preliminary evaluation of the appropriateness of the taxpayer's claimed deductions. Previously, the Internal Revenue Service found it difficult to make such a preliminary evaluation without auditing the taxpayer, which can also be a significant burden on the taxpayer.

Therefore, the conferees intend that individual taxpayers (whether employees or self-employed) claiming deductions or credits for business use of an automobile or other listed property subject to the substantiation standards of section 274(d) are to provide on their returns the substance of the information (generally on appropriate existing tax forms) called for by all the questions as set forth in the House report on the bill.[9] Corporate taxpayers, as well as all [11] other taxpayers and entities, claiming such deductions or credits also are to be asked to supply such information on the forms or schedules they are required to file.

The conferees have carefully considered the fact that furnishing additional tax return information, although involving only a limited number of questions, requires some additional effort by taxpayers. However, the conferees note that computations involved with respect to vehicles (such as mileage and percentage of business use) normally would be made by taxpayers in the process of determining the proper amount of deductions and credits to claim, and that other information can be obtained through "yes" or "no" questions. Accordingly, to achieve better compliance and more accurate computations, the conference agreement directs the Internal Revenue Service to obtain this information on appropriate tax forms or schedules, notwithstanding any otherwise applicable paperwork reduction considerations.

The conferees intend that employees give this return information to their employers with respect to employer-provided vehicles. Generally, the employer would report this information on its tax return, since the employer is claiming the tax deductions or credits for use of the vehicle. An employer which provides more than five cars to its employees, however, would not have to include all this information on the employer's return; instead, such an employer must obtain this information from its employees, must so indicate on its return, and must retain the information received. The Internal Revenue Service could then examine on audit the information that the employees have provided to the employer. An employer may rely on such a statement from an employee (unless the employer knows or has reason to know it is false) to determine the credits and deductions to which the employer is entitled and to determine the amount, if any, which must be included in employee's incor

[7] Of course, if in fact the employee uses the vehicle for personal purposes in violation of the particular type of written policy statement, then the employee has additional gross income.

[8] This restriction, which makes this rule inapplicable to officers or one-percent owners, applies for substantiation purposes under the conference agreement. The treatment of commuting use of vehicles by such persons for valuation purposes is to be determined separately under Treasury regulations. No inference is intended, on the basis of the exclusion of officers and one-percent owners from eligibility under this substantiation rule, as to the treatment of commuting use of vehicles by such persons under valuation rules prescribed by Treasury regulations.

[9] In the case of a vehicle, the information required to be requested on the tax return relates to mileage (total, business, commuting, and other personal), percentage of business use, date placed in service, use of other vehicles and after-work use, whether the taxpayer has evidence to support the business use claimed on the return, and whether or not the evidence is written. In the case of other listed property subject to the section 274(d) rules, information should be requested in connection with appropriate tax forms or schedules as to type of property (e.g., yacht computer, airplane, etc.), percentage of business use, whether the taxpayer has written evidence to support the business use claimed on the return, a whether or not the evidence is written. Under t conference agreement, the Internal Reven Service is not required to request on returns t specific question relating to computers set fo as question 2 on page 10 of the committee rep on the House bill.

and wages by the employer because of the employee's commuting or other personal use of the employer-provided car.

Effective dates

The modification to the substantiation standards of section 274(d) that provides that taxpayers must substantiate deductions or credits subject to that provision by adequate records or sufficient evidence corroborating their own statement is effective January 1, 1985.

Use of listed property that was not subject to section 274(d) substantiation rules prior to the 1984 Act (such as local travel in an automobile or use of computers) is subject to the section 274(d) substantiation requirements effective January 1, 1986.[10] For 1985, use [12] of such listed property is not subject to the special substantiation standards under section 274(d).

The tax return information (described above) must be requested on returns for taxable years beginning in 1985 (i.e., in the case of most individuals, returns which must be filed by April 15, 1986.)

3. Repeal of regulations

Present law

The Internal Revenue Service has issued temporary regulations implementing the recordkeeping provisions of section 179(b) of the 1984 Act.

House bill

The House bill repeals all Treasury regulations (temporary or proposed) issued prior to the enactment of this House bill that carry out the amendments made by section 179(b) of the Tax Reform Act of 1984. Thus, such regulations issued to implement the changes to section 274(d) made by that Act, particularly the inclusion in that section of the word "contemporaneous," are revoked.[11] In addition, any regulations relating to the return preparer provision and the special negligence penalty (described above) are revoked.[12] These revoked regulations are to have no force and effect whatsoever.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment. Thus, the conference agreement provides that regulations issued to carry out the amendments made by paragraphs (1)(C), (2), and (3) of section 179(b) of the 1984 Act shall have no force and effect.

B. Repeal of Provisions Relating to Return Preparers (sec. 1(b) of the House bill and sec. 1(c) of the Senate amendment)

Present law

Return preparers must advise taxpayers of the substantiation requirements under section 274(d) and obtain written confirmation that those requirements have been met (Code section 6695(b)).

[13] *House bill*

The House bill repeals this provision, effective as if it had never been enacted.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment.

C. Repeal of Special Negligence Penalty (sec. 1(b) of the House bill and sec. 1(c) of the Senate amendment)

Present law

A special no-fault negligence penalty (Code sec. 6653(h)) applies to the portion of any understatement of tax attributable to failure to meet the substantiation requirements of section 274(d).

House bill

The House bill repeals this special negligence penalty, effective as if it had never been enacted.

Senate amendment

The Senate amendment is the same as the House bill.

Conference agreement

The conference agreement follows the House bill and the Senate amendment. The conference agreement provides that the Internal Revenue Code shall be applied and administered as if this special negligence penalty had never been enacted.

The conferees believe that repealing this special negligence penalty is needed to restore to the Internal Revenue Service and the courts discretion not to impose the negligence penalty for minor, inadvertent recordkeeping or computational errors. The conferees emphasize, however, that the regular negligence and fraud penalties will continue to be applicable if a taxpayer claims tax benefits that cannot be supported. The conferees are concerned that these regular negligence and fraud penalties have not been applied by the Internal Revenue Service or the courts in a substantial number of instances where their application would be fully justified.

In one Tax Court case, for example, the taxpayer had kept detailed mileage records, required by his employer for reimbursement purposes, that indicated that his business use was approximately five percent of total use. On his tax return, the taxpayer claimed 70 percent business use, with no records, to justify this claim. The Tax Court properly allowed only five percent business use. The Court did not, however, impose a negligence or fraud penalty. The conferees believe that, in a case like this one, the regular negligence penalty should certainly be imposed, and that careful consideration should be given to

[10] This January 1, 1986 effective date applies only to the extent that use of listed property was first made subject to the substantiation standards of section 274(d) by the 1984 Act. Deductions for expenses or items that were subject to the section 274(d) substantiation standards prior to the 1984 Act (such as use of an automobile for travel away from home or use of a yacht that is an entertainment, recreation, or amusement facility) remain subject to the section 274(d) substantiation standards for all taxable years ending after December 31, 1962.

[11] Also, the provisions of the temporary regulations that prohibit an employer from including the entire value of the use of an automobile in the income of certain employees are revoked. Thus, an employer is permitted to charge the entire value of an employer-provided car to an employee as income and wages (for income tax, FICA, FUTA, and RRTA withholding purposes). The employer may then reimburse the employee for the business use of the car, or the employee may claim a deduction on the employee's income tax return for the business use of the car.

[12] The bill only revokes such regulations and (issued prior to enactment) carrying out such amendments made by sections 179(b)(1)(C), (2), and (3) of the 1984 Act. Thus, the bill does not revoke any other regulations, such as regulations issued under sections 61 and 132 (relating to valuation).

imposing the civil fraud penalty.

In another Tax Court case, the taxpayer had kept detailed records so that he could be reimbursed by his employer, but [14] claimed on his tax return approximately 35,000 miles of business use beyond what his records demonstrated, without any justification. No negligence penalty was imposed. In another case, the taxpayer produced a diary purporting to justify the claimed deductions. The Tax Court called the diary a "fabrication" and said that the taxpayer "was not telling the truth." The Court still permitted him a deduction, and did not impose the regular negligence or civil fraud penalty. Finally, another taxpayer apparently claimed a deduction for business mileage that exceeded the total mileage shown on his odometer, but the Tax Court did not impose a negligence or civil fraud penalty.

These cases indicate that the regular negligence and civil fraud penalties are not being administered by either the Internal Revenue Service or the courts in the manner that the Congress intended when it initially enacted these penalties. While minor, inadvertent recordkeeping or computational errors should not lead to the imposition of a substantial penalty, the conferees believe that it is vital to the integrity of the tax system that honest taxpayers know that others who claim tax benefits far in excess of what can be justified will be subject to the negligence and fraud penalties.

D. Exceptions From Section 274(d) Rules and Exclusion From Income for Certain Vehicles (sec. 2(b) of the House bill and sec. 2 of the Senate amendment)

Present law

Substantiation rules

Temporary Treasury regulations provided that, except for vehicles used for commuting, vehicles of a type ordinarily not susceptible to personal use do not constitute listed property to which the section 274(d) substantiation requirements apply. The regulations cited, as examples of such vehicles that are not susceptible to personal use, trucks specially designed for specific business purposes (such as refrigerated delivery trucks), special-purpose farm vehicles (such as tractors and combines), cement mixers, and forklifts.

Income inclusion

The fair market value of an employer-provided fringe benefit, such as personal use by an employee of an employer-provided vehicle, is included in the employee's gross income, and in wages for purposes of withholding and FICA, FUTA, and RRTA taxes, unless excluded under a specific statutory provision of the Code (secs. 61(a)(1), 3121(a), 3231(e), 3306(b), 3401(a)).

House bill

Substantiation rules

The House bill exempts from the section 274(d) substantiation rules (as modified by the bill) any vehicle that, by reason of its nature, is not likely to be used more than a de minimis amount for personal purposes. This provision is effective for taxable years beginning after December 31, 1985; thus, for 1985 the pre-1984 Act substantiation rules continue to apply with respect to such vehicles.

[15] The committee report on the House bill lists the following vehicles as examples of vehicles exempted under the bill from the section 274(d) substantiation rules: (a) clearly marked police and fire vehicles (as described in the report); (b) delivery trucks with seating only for the driver, or only for the driver plus a folding jump seat; (c) flatbed trucks; (d) any vehicle designed to carry cargo with a loaded gross vehicle weight over 14,000 pounds; (e) passenger buses used as such with a capacity of at least 20 passengers; (f) ambulances used as such or hearses used as such; (g) bucket trucks ("cherry pickers"); (h) cranes and derricks; (i) forklifts; (j) cement mixers; (k) dump trucks (including garbage trucks); (l) refrigerated trucks; (m) tractors; and (n) combines.

The report on the House bill also states that the committee recognizes that it may not have developed an exhaustive list of vehicles not susceptible to personal use. Therefore, the report states, the committee intends that the Internal Revenue Service is to expand this list through either regulations or revenue rulings to include any vehicles not included in the listing in the report that are appropriate for listing because by their nature it is highly unlikely that they will be used more than a very minimal amount for personal purposes.

The report also states that the committee did not generally exempt from the section 274(d) substantiation rules all pickup trucks and vans, because these vehicles can easily be used for personal purposes. Some taxpayers purchase these vehicles as substitutes for passenger sedans, and use them predominantly (or entirely) for personal purposes. On the other hand, however, the committee report recognized that this is not applicable to all vans. For example, a van that has only a front bench for seating in which permanent shelving[13] has been installed, that constantly carries merchandise, and that has been specially painted with advertising or the company's name, is a vehicle not susceptible to personal use.

Income inclusion

The committee report on the House bill states that it is appropriate for Treasury regulations to provide that under certain conditions all use by an employee of any employer-provided vehicle that is exempted under the House bill from the section 274(d) substantiation rules (see above) is excluded, as a working condition fringe benefit (sec. 132(a)(3)),[14] from the employee's gross income, and from wages (and, where appropriate, from the benefit base) for purposes of FICA, FUTA, and RRTA taxes. Such exclusions pursuant to Treasury regulations are to be effective as of January 1, 1985.

Senate amendment

Substantiation rules

The Senate amendment provides that the following vehicles are exempt from the section 274(d) substantiation rules (as modified by [16] the amendment) and that any commuting or other personal use of such exempted vehicles is excluded from the user's gross income and from the wages (and, where appropriate, from the benefit base) for pur

[13] It is intended that this shelving fill most o the cargo area.

[14] Absent such a special exclusion, commutin use (or other personal use) by an employee of a employer-provided vehicle could not qualify as working condition fringe benefit because th costs of commuting to and from work (or of othe personal use of a vehicle) are nondeductible pur suant to Code section 262. *See*, e.g., *Fausner v Comm'r*, 413 U.S. 838 (1973) [1974-2 C.B. 42]

poses of FICA, FUTA, and RRTA taxes, effective January 1, 1985:

(a) Vehicles required to be used as an integral part of the trade or business of an individual or of the employer (such as calling on customers or clients, making deliveries, or visiting job sites), so long as use in the trade or business is at least 75 percent of the vehicle's total use;

(b) Vehicles used by an employee for commuting, where the commuting is for a bona fide business purpose, where the employer does not permit the employee to make other personal use of the vehicle (other than de minimis use), and where use in the trade or business of the employer is at least 75 percent of total use; and

(c) Vehicles used by a governmental unit for police or other law enforcement purposes and vehicles used as an ambulance.

Income inclusion

The Senate amendment provides that any commuting or other personal use of such exempted vehicles (described above) is excluded from the user's gross income, and from wages (and, where appropriate, from the benefit base) for purposes of FICA, FUTA, and RRTA taxes, effective January 1, 1985.

ITC and depreciation cups

The Senate and amendment provides that police and law enforcement vehicles and ambulances placed in service after June 18, 1984 are exempt from the investment tax credit and depreciation limitations set forth in section 280F.

Conference agreement

The conference agreement follows the House bill, with the following modifications.

The conferees intend that school buses (as defined in Code section 4221(d)(7)(C)), qualified specialized utility repair trucks, and qualified moving vans, in addition to the list above (items (a) through (n) in the description of the House bill), are also to be examples of vehicles that, by reason of their nature, are not likely to be used more than a de minimis amount for personal purposes.

The term "qualified specialized utility repair trucks" means trucks (not including vans or pickup trucks) specifically designed and used to carry heavy tools, testing equipment, or parts where (1) the shelves, racks, or other permanent interior construction which has been installed to carry and store such heavy items is such that it is unlikely that the truck will be used more than a very minimal amount for personal purposes[15] and (2) the employer requires the employee to drive the truck home in order to be able to respond in emergency situations for purposes of restoring or maintaining electricity, gas, telephone, water, sewer, or steam utility services.

[17] The term "qualified moving vans" means vans used by professional moving companies in the trade or business of moving household or business goods where no personal use of the van is allowed other than for travel to and from a move site (or for de minimis use), where personal use for travel to and from a move site is an irregular practice (i.e., not more than five times a month on average), and where personal use is limited to situations in which it is more convenient to the employer, because of the location of the employee's residence, for the van not to be returned to the employer's business location.

Also, the conferees agreed that the Treasury Department has authority to issue regulations exempting from the section 274(d) substantiation rules, and from inclusion in income and wages, officially authorized uses of unmarked vehicles by law enforcement officers. To qualify for this exemption, the personal use must be authorized by the Federal, State, county, or local governmental agency or department that owns or leases the vehicle and employs the officer, and must be for law-enforcement functions such as undercover work or reporting directly from home to a stakeout or surveillance site, or to an emergency situation. Use of an unmarked vehicle for vacation or recreation trips cannot qualify as an authorized use. The term "law enforcement officer" means an individual who is employed on a full-time basis by a governmental unit that is responsible for the prevention or investigation of crime involving injury to persons or property, who is authorized by law to carry firearms and execute search warrants and also to make arrests (other than merely a citizen arrest), and who regularly carries firearms (except when it is not possible to do this because of the requirements of undercover work). The term "law enforcement officer" does not include Internal Revenue Service special agents.

The conference agreement also provides that if, for example, a municipal government ordinance requires that police officers driving clearly marked police cars who are on duty at all times must take the vehicle home when the employee is not on his or her regular shift, and prohibits any personal use (except for this commuting use) of the vehicle outside the city (i.e., outside the limit of the officer's arrest powers), then all use of the vehicle could be considered in such regulations as an excludable working condition fringe.

E. Withholding Election (sec. 3 of the House bill)

Present law

As authorized under the 1984 Act, temporary Treasury regulations have provided for withholding (or payment) of income and employment taxes with respect to taxable noncash fringe benefits, such as an employee's personal use of an employer-provided vehicle, on a quarterly basis (Code sec. 3501(b)).

House bill

The House bill provides that an employer may elect not to deduct and withhold income taxes with respect to the noncash fringe benefit attributable to an employee's personal use of a highway motor vehicle provided by the employer. An employer making this election must so notify the employee (at such time and in such [18] manner as provided in Treasury regulations) and must include the fair market value of the benefit on the Form W-2 furnished to the employee. An electing employer must still withhold social security (or railroad retirement) taxes. This provision is effective as of January 1, 1985.

[15] An example of this would be permanent shelving that fills most of the cargo area.

The committee report on the House bill states that the committee intends that the regulations are to be revised to allow an employer to elect, for income and employment tax purposes, to treat taxable fringe benefits (including personal use of employer-provided automobiles) as paid on a pay period, quarterly, semi-annual, or annual basis.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill.

F. Limitations on Investment Tax Credit and Depreciation for Automobiles (sec. 4 of the House bill)

Present law

The 1984 Act generally imposed limitations on the amount of investment tax credit and annual depreciation deductions that are allowed for an automobile placed in service or leased by the taxpayer after June 18, 1984.

For an automobile placed in service in 1984, (1) the investment tax credit is limited to $1,000; (2) depreciation in the first taxable year the automobile is placed in service is limited to $4,000; and (3) depreciation in any subsequent taxable year is limited to $6,000. For years after 1984, the limits are adjusted for inflation, as measured by the percentage growth of the automobile component of the Consumer Price Index for All Urban Consumers between October of the preceding year and October, 1983. The adjusted limits for any year apply only to automobiles placed in service in that year.

House bill

The limits on the amount of investment tax credit and annual depreciation deductions that may be claimed with respect to an automobile are reduced as follows under the House bill; (1) the investment tax credit is limited to $675; (2) depreciation in the first taxable year the automobile is placed in service is limited to $3,600 and (3) depreciation in any subsequent taxable year is limited to $5,400. For years after 1985, the reduced limits are indexed for inflation, as measured by the percentage growth of the automobile component of the Consumer Price Index for All Urban consumers between Otober of the preceding year and October, 1984. Adjustments for inflation are otherwise determined as under present law. The committee report states that the committee intends that the Secretary of the Treasury prescribe all limits adjusted for inflation.

[19] The reduced limits are generally effective for property placed in service or leased by the taxpayer after April 2, 1985. However, property acquired by the taxpayer pursuant to a binding contract in effect on April 1, 1985, and at all times thereafter, is not subject to the reduced limits if it is placed in service before August 1, 1985; and property of which the taxpayer is the lessee pursuant to a binding contract in effect on April 1, 1985, and all times thereafter, is not subject to the reduced limits if the taxpayer first uses the property under the lease before August 1, 1985.

Senate amendment

No provision.

Conference agreement

The conference agreement follows the House bill, with three modifications: (1) depreciation in the first taxable year is limited to $3,200; (2) depreciation in any subsequent taxable year is limited to $4,800; and (3) the reduced limits on the investment credit and depreciation are not indexed for inflation until 1989. For automobiles placed in service in any year after 1988, the reduced limits are adjusted for the precentage increase of the automobile component of the Consumer Price Index for All Urban Consumers between October of the preceding year and October, 1987. The conferees made these changes to the House bill to ensure that the conference agreement is revenue neutral.

G. New Regulations (sec. 5 of the House bill)

Present law

The Treasury Department has the authority to issue regulations under the Internal Revenue Code.

House bill

The House bill requires that the Treasury Department issue regulations to carry out the provisions of the Hous bill not later than October 1, 1985.

Senate amendment

No provision.

Conference agreement

The conference agreement follow the House bill. Because the confere have delayed applicability of the se tion 274(b) substantiation rules to loc travel, computers, etc., until January 1986, the conferees believe that requi ing regulations to be issued by Octob 1, 1985, will provide taxpayers wit sufficient time to prepare to meet thes requirements.

Public Law 99-107
99th Congress, H.R. 3452
September 30, 1985

An Act to extend for 45 days the ap plication of tobacco excise taxes, trad adjustment assistance, certain medica reimbursement provisions, and bor rowing authority under the railroa unemployment insurance program.

Be it enacted by the Senate an House of Representatives of the Unite States of America in Congres assembled,

SECTION 1. SHORT TITLE

This Act may be cited as the "Emergency Extension Act of 1985."

SEC. 2. 45-DAY EXTENSION OF INCREASE IN TAX ON CIGARETTES.

Subsection (c) of section 283 of the Tax Equity and Fiscal Responsibility Act of 1982 (relating to increase in tax on cigarettes) is amended by striking out "October 1, 1985" and inserting in lieu thereof "November 15, 1985."

SEC. 3. 45-DAY EXTENSION OF TRADE ADJUSTMENT ASSISTANCE PROGRAM

Section 285 of the Trade Act of 1974 (19 U.S.C. note preceding section 2271) is amended by striking out "September 30, 1985" and inserting in lieu thereof "November 14, 1985"

SEC. 4. 45-DAY EXTENSION OF BORROWING AUTHORITY UNDER THE RAILROAD UNEMPLOYMENT INSURANCE ACT

Section 10(d) of the Railroad Unemployment Insurance Act is amended by striking out "September 30, 1985" each place it appears and inserting in lieu thereof "November 14, 1985.

SEC. 5. 45-DAY EXTENSION OF MEDICARE HOSPITAL AND PHYSICIAN PAYMENT PROVISIONS

(a) MAINTAINING EXISTING HOSPITAL PAYMENT RATES.—Notwithstanding any other provision of law, the amount of payment under section 1886 of the Social Security Act for inpatient hospital services for discharges occurring (and cost reporting periods beginning) during the extension period (as defined in subsection (c)) shall be determined on the same basis as the amount of payment for such services for a discharge occurring on (or the cost reporting period beginning immediately on or before) September 30, 1985.

(b) MAINTAINING EXISTING PAYMENT RATES FOR PHYSICIANS' SERVICES.—Notwithstanding any other provision of law, the amount of payment under part B of title XVIII of the Social Security Act for physicians' services which are furnished during the extension period (as defined in subsection (c)) shall be determined on the same basis as the amount of payment for such services furnished on September 30, 1985, and the 15-month period, referred to in section 1842(j)(1) of such Act, shall be deemed to include the extension period.

(c) EXTENSION PERIOD DEFINED.—For purposes of this section, the term "extension period" means the period beginning on October 1, 1985, and ending on November 14, 1985.

Approved September 30, 1985.

Public Law 99-121
99th Congress, H.R. 2475[1]
October 11, 1985

Act to amend the Internal Revenue Code of 1954 to simplify the imputed interest rules of sections 1274 and 483, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE I—AMENDMENTS TO IMPUTED INTEREST RULES

SECTION 101. SIMPLIFICATION OF GENERAL IMPUTED INTEREST RULES

(a) Reduction of Imputation Rate From 120 to 100 Percent; Elimination of Separate Testing Rate.—

(1) Amendments of section 1274.—

(A) Subparagraph (B) of section 1274(b)(2) of the Internal Revenue Code of 1954 (defining imputed principal amount) is amended by striking out "120 percent of"

(B) Clause (ii) of section 1274(c)(1)(A) of such Code is amended to read as follows:

"(ii) in any other case, the imputed principal amount of such debt instrument determined under subsection (b), and".

(C) Paragraph (2) of section 1274(c) of such Code is amended by striking out "the testing amount" and inserting in lieu thereof "the imputed principal amount of such debt instrument determined under subsection (b)"

(D) Subsection (c) of section 1274 of such Code is amended by striking out paragraph (3) and by redesignating paragraph (4) as paragraph (3).

(2) Amendments of section 483.—

(A) The last sentence of section 483(b) of such Code (defining total unstated interest) is amended by striking out "120 percent of".

(B) Subparagraph (B) of section 483(c)(1) of such Code is amended to read as follows:

"(B) under which there is total unstated interest."

(b) Interest Rates Redetermined Each Month.—

(1) In general.—Paragraph (1) of section 1724(d) of such Code (defining applicable Federal rate) is amended by striking out subparagraphs (B), (C), and (D) and inserting in lieu thereof the following:

"(B) Determination of rates.— During each calendar month, the Secretary shall determine the Federal short-term rate, mid-term rate, and long-term rate which shall apply during the following calendar month.

"(C) Federal rate for any calendar month.—For purposes of this paragraph—

"(i) Federal short-term rate.—The Federal short-term rate shall be the rate determined by the Secretary based on the average market yield (during any 1-month period selected by the Secretary and ending in the calendar month in which the determination is made) on outstanding marketable obligations of the United States with remaining periods to maturity of 3 years or less.

"(ii) Federal mid-term and long-term rates.—The Federal mid-term and long-term rate shall be determined in accordance with the principles of clause (i).

"(D) Lower rate permitted in certain cases.—The Secretary may by regulations permit a rate to be used with respect to any debt instrument which is lower than the applicable Federal rate if the taxpayer establishes to the satisfaction of the Secretary that such lower rate is based on the same principles as the applicable Federal rate and is appropriate for the term of such instrument."

(2) Rate applicable to any sale or exchange.—Paragraph (2) of section 1274(d) of such Code (relating to rate applicable to any sale or exchange) is amended to read as follows:

"(2) Lowest 3-month rate applicable to any sale or exchange.—

"(A) In general.—In the case of any sale or exchange, the applicable Federal rate shall be the lowest 3-month rate.

"(B) Lowest 3-month rate.—For purposes of subparagraph (A), the term 'lowest 3-month rate' means the lowest of the applicable Federal rates in effect for any month in the 3-calendar-month period ending with the 1st calendar month in which there is a binding contract in writing for such sale or exchange."

(c) Rate Increased to 110 Percent in Case of Sale-leaseback.—Section 1274 of such Code (relating to determination of issue price in the case of certain debt instruments issued for property) is amended by adding at the end thereof the following new subsection:

"(e) 110 Percent Rate Where Sale-

[1]House Report No. 99-87, page 371; Senate Report No. 99-83; page 379; Conference Report No. 99-250, page 390.

Leaseback Involved.—

"(1) In general.—In the case of any debt instrument to which this subsection applies, the discount rate used under subsection (b)(2)(B) or section 483(b) shall be 110 percent of the applicable Federal rate, compounded semiannually.

"(2) Lower discount rates shall not apply.—Section 1274A shall not apply to any debt instrument to which this subsection applies.

"(3) Debt instruments to which this subsection applies.—This subsection shall apply to any debt instrument given in consideration for the sale or exchange of any property if, pursuant to a plan, the transferor or any related person leases a portion of such property after such sale or exchange."

"SEC. 102. LOWER DISCOUNT RATE IN CASE OF CERTAIN SALES WHERE STATED PRINCIPAL AMOUNT DOES NOT EXCEED $2,800,000

(a) General Rule.—Subpart A of part V of subchapter P of chapter 1 of the Internal Revenue Code of 1954 (relating to original issue discount) is amended by inserting after section 1274 the following new section:

"SEC. 1274A. SPECIAL RULES FOR CERTAIN TRANSACTIONS WHERE STATED PRINCIPAL AMOUNT DOES NOT EXCEED $2,800,000

"(a) Lower Discount Rate.—In the case of any qualified debt instrument, the discount rate used for purposes of sections 483 and 1274 shall not exceed 9 percent, compounded semiannually.

"(b) Qualified Debt Instrument Defined.—For purposes of this section, the term 'qualified debt instrument' means any debt instrument given in consideration for the sale or exchange of property (other than new section 38 property within the meaning of section 48(b)) if the stated principal amount of such instrument does not exceed $2,800,000.

"(c) Election To Use Cash Method Where Stated Principal Amount Does Not Exceed $2,000,000.—

"(1) In general.—In the case of any cash method debt instrument—

"(A) section 1274 shall not apply, and

"(B) interest on such debt instrument shall be taken into account by both the borrower and the lender under the cash receipts and disbursements method of accounting.

"(2) Cash method debt instrument.—For purposes of paragraph (1), the term 'cash method debt instrument' means any qualified debt instrument if—

"(A) the stated principal amount does not exceed $2,000,000,

"(B) the lender does not use an accrual method of accounting and is not a dealer with respect to the property sold or exchanged,

"(C) section 1274 would have applied to such instrument but for an election under this subsection, and

"(D) an election under this subsection is jointly made with respect to such debt instrument by the borrower and lender.

"(3) Successors bound by election.—

"(A) In general.—Except as provided in subparagraph (B), paragraph (1) shall apply to any successor to the borrower or lender with respect to a cash method debt instrument.

"(B) Exception where lender transfers debt instrument to accrual method taxpayer.—If the lender (or any successor) transfers any cash method debt instrument to a taxpayer who uses an accrual method of accounting, this paragraph shall not apply with respect to such instrument for periods after such transfer.

"(4) Fair market value rule in potentially abusive situations.—In the case of any cash method debt instrument, section 483 shall be applied as if it included provisions similar to the provisions of section 1274(b)(3).

"(d) Other Special Rules.—

"(1) Aggregation rules.—For purposes of this section—

"(A) all sales or exchanges which are part of the same transaction (or a series of related transactions) shall be treated as 1 sale or exchange, and

"(B) all debt instruments arising from the same transaction (or a series of related transactions) shall be treated as 1 debt instrument.

"(2) Inflation adjustments.—

"(A) In general.—In the case of any debt instrument arising out of a sale or exchange during any calendar year after 1989, each dollar amount contained in the preceding provisions of this section shall be increased by the inflation adjustment for such calendar year. Any increase under the preceding sentence shall be rounded to the nearest multiple of $100 (or, if such increase is a multiple of $50, such increase shall be increased to the nearest multiple of $100).

"(B) Inflation adjustment.—For purposes of subparagraph (A), the inflation adjustment for any calendar year is the percentage (if any) by which—

"(i) the CPI for the preceding calendar year exceeds

"(ii) the CPI for calendar year 1988.

For purposes of the preceding sentence, the CPI for any calendar year is the average of the Consumer Price Index as of the close of the 12-month period ending on September 30 of such calendar year.

"(e) Regulations.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including—

"(1) regulations coordinating the provisions of this section with other provisions of this title,

"(2) regulations necessary to prevent the avoidance of tax through the abuse of the provisions of subsection (c), and

"(3) regulations relating to the treatment of transfers of cash method debt instruments."

(b) Exception for Assumptions.—Subsection (c) of section 1274 of such Code is amended by adding at the end thereof the following new paragraph:

"(4) Exception for assumptions.—If any person—

"(A) in connection with the sale or exchange of property, assumes an debt instrument, or

"(B) acquires any property subject to any debt instrument,

in determining whether this section or section 483 applies to such debt instrument, such assumption (or such acquisition) shall not be taken into account unless the terms and conditions of such debt instrument are modified (or the nature of the transaction is changed) in connection with the assumption (or acquisition)."

(c) Technical Amendments.—

(1) Section 483 of such Code is amended by striking out subsection (f) and by redesignating subsections (g), and (h) as subsections (e), (f), and (g), respectively.

(2) Paragraph (1) of section 483(e) of such Code (as redesignated by paragraph (1)) is amended by striking out "7 percent" and inserting in lieu thereof "6 percent".

(3) Subsection (g) of section 483 of such Code (as redesignated by paragraph (1)) is amended to read as follows:

"(g) Cross References.—

"(1) For treatment of assumptions, see section 1274(c)(4).

"(2) For special rules for certain transactions where stated principal amount does not exceed $2,800,000 see section 1274A.

"(3) For special rules in case of the borrower under certain loans for personal use, see section 1275(b)."

(4) Paragraph (4) of section 280G(d) of such Code is amended by striking out "in accordance with section 1274(b)(2)" and inserting in lieu thereof "by using a discount rate equal to 120 percent of the applicable Federal rate (determined under section 1274(d)), compounded semiannually".

(d) Clerical Amendment.—The table of sections for subpart A of part V of subchapter P of chapter 1 of such Code is amended by inserting after the item relating to section 1274 the following new item:

"Sect. 1274A. Special rules for certain transactions where stated principal amount does not exceed $2,800,000."

SEC. 103. RECOVERY PERIOD FOR 18-YEAR REAL PROPERTY EXTENDED TO 19 YEARS

(a) In General.—Clause (i) of section 168(b)(2)(A) of the Internal Revenue Code of 1954 (relating to amount of deduction for 18-year real property) is amended by striking out "18-year recovery period" and inserting in lieu thereof "19-year recovery period".

(b) Technical Amendments.—

(1) The following provisions of the Internal Revenue Code of 1954 are amended by striking out "18-year real property" each place it appears in the text and headings thereof and inserting in lieu thereof "19-year real property":

(A) Section 168 (relating to accelerated cost recovery system).

(B) Section 57(a)(12) (relating to preference for accelerated cost recovery deduction).

(C) Section 312(k)(3)(A) (relating to earnings and profits).

(D) Subparagraphs (A), (B), and (C) of section 1245(a)(5) (relating to gain dispositions of certain depreciable property).

(2) the table contained in subparagraph (A) of section 168(b)(3) of such Code (relating to election of different recovery percentage) is amended by striking out "18, 35, or 45" and inserting in lieu thereof "19, 35, or 45 years".

(3)(A) Subparagraph (B) of section 168(f)(1) of such Code (relating to components of section 1250 class property) is amended by redesignating clause (iii) as clause (iv) and by inserting after clause (ii) the following new clause:

"(iii) Buildings placed in service before May 9, 1985.—In the case of any building placed in service by the taxpayer before May 9, 1985, for purposes of applying subparagraph (A) to components of such buildings placed in service after May 8, 1985, the deduction allowable under subsection (a) with respect to such components shall be computed in the same manner as the deduction allowable with respect to the first component placed in service after May 8, 1985."

(B) Clause (ii) of section 168(f)(1)(B) of such Code is amended by striking out "March 15, 1984, the" and inserting in lieu thereof "March 15, 1984, and before May 9, 1985, the"

(c) Clause (iv) of section 168(f)(1)(B) of such Code, as redesignated by subparagraph (A), is amended by striking out "or (ii)" and inserting in lieu thereof ", (ii), or (iii)".

(4) clause (ii) of section 168(f)(12)(B) of such Code (relating to limitations for property financed with tax-exempt bonds) is amended—

(A) by striking out "15-year real property" each place it appears in the heading and the text and inserting in lieu thereof "19-year real property", and

(B) by striking out "15 years" and inserting in lieu thereof "19 years".

(5) Paragraph (2) of section 48(g) of such Code (relating to special rules for qualified rehabilitated buildings) is amended by striking out "18" in subparagraphs (A)(i) and (B)(v) thereof and inserting in lieu thereof "19".

(6) The table contained in subparagraph (B) of section 47(a)(5) of such Code (relating to special rules for recovery property) is amended by striking out "For 15-year, 10-year, and 5-year property" and inserting in lieu thereof "For property other than 3-year property".

(7) Clause (i) of section 57(a)(12)(B) of such Code (relating to real property and low-income housing) is amended by striking out "18 years" and inserting in lieu thereof "19 years".

SEC. 104. SPECIAL RULE FOR CERTAIN WORKOUTS

(a) General Rule.—Sections 483 and 1274 of the Internal Revenue Code of 1954 shall not apply to the issuance or modification of any written indebtedness if—

(1) such issuance or modification is in connection with a workout of a specified MLC loan which (as of May 31, 1985) was substantially in arrears, and

(2) the aggregate principal amount of indebtedness resulting from such workout does not exceed the sum (as of the time of the workout) of the outstanding principal amount of the specified MLC loan and any arrearages on such loan.

(b) Specified MLC Loan.—For purposes of subsection (a), the term "specified MLC loan" means any loan which, in a submission dated June 17, 1985, on behalf of the New York State Mortgage Loan Enforcement and Administration Corporation, had one of the following loan numbers: 001, 005, 007, 012, 025, 038, 041, 042, 043, 049, 053, 064, 068, 090, 141, 180, or 188.

SEC. 105. EFFECTIVE DATES

(a) Sections 101 and 102.—

(1) In general.—Except as provided in paragraph (2), the amendments made by sections 101 and 102 shall apply to sales and exchanges after June 30, 1985, in taxable years ending after such date. The amendment made by section 2 of Public Law 98-612 shall not apply to sales and exchanges after June 30, 1985, in taxable years ending after such date.

(2) Regulatory authority to establish lower rate.—Section 1274(d)(1)(D) of the Internal Revenue Code of 1954, as added by section 101(b), shall apply as if included in the amendments made by section 41 of the Tax Reform Act of 1984.

(b) Section 103.—

(1) In general.—Except as otherwise provided in this subsection, the amendments made by section 103 shall apply with respect to property placed in service by the taxpayer after May 8, 1985.

(2) Exception.—The amendments made by section 103 shall not apply to property placed in service by the taxpayer before January 1, 1987, if—

(A) the taxpayer or a qualified person entered into a binding contract to purchase or construct such property before May 9, 1985, or

(B) construction of such property was commenced by or for the taxpayer or a qualified person before May 9, 1985.

For purposes of this paragraph, the term "qualified person" means any person whose rights in such a contract or such property are transferred to the taxpayer, but only if such property is not placed in service before such rights are transferred to the taxpayer.

(3) Special rule for components.—For purposes of applying section 168(f)(1)(B) of the Internal Revenue Code of 1954 (as amended by section 103) to components placed in service after December 31, 1986, property to which paragraph (2) of this subsection applies shall be treated as placed in service by the taxpayer before May 9, 1985.

(4) Technical correction.—The amendment made by paragraph (6) of section 103(b) shall apply as if included in the amendments made by section 111 of the Tax Reform Act of 1984.

(5) Special rule for leasing of qualified rehabilitated buildings.—The amendment made by paragraph (5) of section 103(b) to section 48(g)(2)(B)(v) of the Internal Revenue Code of 1954 shall not apply to leases entered into before May 22, 1985, but only if the lessee signed the lease before May 17, 1985.

TITLE II—AMENDMENTS TO BELOW-MARKET INTEREST RULES

SEC. 201. CERTAIN LOANS TO QUALIFIED CONTINUING CARE FACILITIES EXEMPT FROM BELOW-MARKET INTEREST RATE RULES

(a) In General.—Section 7872 of the Internal Revenue Code of 1954 (relating to treatment of loans with below-market interest rates) is amended by redesignating subsection (g) as subsection (h) and by inserting after subsection (f) the following new subsection:

"(g) Exception for Certain Loans to Qualified Continuing Care Facilities.—

"(1) In general.—This section shall not apply for any calendar year to any below-market loan made by a lender to a qualified continuing care facility pursuant to a continuing care contract if the lender (or the lender's spouse) attains age 65 before the close of such year.

"(2) $90,000 limit.—Paragraph (1) shall apply only to the extent that the aggregate outstanding amount of any loan to which such paragraph applies (determined without regard to this paragraph), when added to the aggregate outstanding amount of all other previous loans between the lender (or the lender's spouse) and any qualified continuing care facility to which paragraph (1) applies, does not exceed $90,000.

"(3) Continuing care contract.—For purposes of this section, the term 'continuing care contract' means a written contract between an individual and a qualified continuing care facility under which—

"(A) the individual or individual's spouse may use a qualified continuing care facility for their life or lives,

"(B) the individual or individual's spouse—

"(i) will first—

"(I) reside in a separate, independent living unit with additional facilities outside such unit for the providing of meals and other personal care, and

"(II) not require long-term nursing care, and

"(ii) then will be provided long-term and skilled nursing care as the health of such individual or individual's spouse requires, and

"(C) no additional substantial payment is required if such individual or individual's spouse requires increased personal care services or long-term and skilled nursing care.

"(4) Qualified continuing care facility.—

"(A) In general.—For purposes of this section, the term 'qualified continuing care facility' means 1 or more facilities—

"(i) which are designed to provide services under continuing care contracts, and

"(ii) substantially all of the residents of which are covered by continuing care contracts.

"(B) Substantially all facilities must be owned or operated by borrower.—A facility shall not be treated as a qualified continuing care facility unless substantially all facilities which are used to provide services which are required to be provided under a continuing care contract are owned or operated by the borrower.

"(C) Nursing homes excluded.—The term 'qualified continuing care facility' shall not include any facility which is of a type which is traditionally considered a nursing home.

"(5) Adjustment of limit for inflation.—

"(A) In general.—In the case of any loan made during any calendar year after 1986 to which paragraph (1) applies, the dollar amount in paragraph (2) shall be increased by the inflation adjustment for such calendar year. Any increase under the preceding sentence shall be rounded to the nearest multiple of $100 (or, if such increase is a multiple of $50, such increase shall be increased to the nearest multiple of $100).

"(B) Inflation adjustment.—For purposes of subparagraph (A), the inflation adjustment for any calendar year is the percentage (if any) by which—

"(i) the CPI for the preceding calendar year exceeds

"(ii) the CPI for calendar year 1985.

For purposes of the preceding sentence, the CPI for any calendar year is the average of the Consumer Price Index as of the close of the 12-month period ending on September 30 of such calendar year."

(b) Clarification of Application of Below-Market Interest Rate Rules to Loans to Qualified Continuing Care Facilities.—Paragraph (1) of section 7872(c) of such Code (relating to below-market loans to which section applies) is amended by adding at the end thereof the following new subparagraph:

(F) Loans to qualified continuing care facilities.—Any loan to any qualified continuing care facility pursuant to

a continuing care contract."

(c) Conforming Amendments.—

(1) Paragraph (1) of section 7872(c) of such Code is amended by inserting "and subsection (g)" after "subsection".

(2) Subparagraph (E) of section 7872(c)(1) of such Code is amended by striking out "or (C)" and inserting in lieu thereof "(C), or (F)".

SEC. 202. TIME FOR DETERMINING RATE APPLICABLE TO EMPLOYEE RELOCATION LOANS

Subsection (f) of section 7872 of the Internal Revenue Code of 1954 (relating to treatment of loans with below-market interest rates) is amended by adding at the end thereof the following new paragraph:

"(11) Time for determining rate applicable to employee relocation loans.—

"(A) In general.—In the case of any term loan made by an employer to an employee the proceeds of which are used by the employee to purchase a principal residence (within the meaning of section 1034), the determination of the applicable Federal rate shall be made as of the date the written contract to purchase such residence was entered into.

"(B) Paragraph only to apply to cases to which section 217 applies.—Subparagraph (A) shall only apply to the purchase of a principal residence in connection with the commencement of work by an employee or a change in the principal place of work of an employee to which section 217 applies."

SEC. 203. SECTION 7872 OF THE INTERNAL REVENUE CODE SHALL NOT APPLY TO NON-LOAN PAYMENTS TO CERTAIN RESIDENTIAL HOUSING FACILITIES FOR THE ELDERLY

(a) General Rule.—For purposes of section 7872 of the Internal Revenue Code of 1954, payments made to a specified independent living facility for the elderly by a payor who is an individual at least 65 years old shall not be treated as loans provided—

(1) the independent living facility is designed and operated to meet some substantial combination of the health, physical, emotional, recreational, social, religious and similar needs of persons over the age of 65;

(2) in exchange for the payment, the payor obtains the right to occupy (or equivalent contractual right) independent living quarters located in the independent living facility;

(3) the amount of the payment is equal to the fair market value of the right to occupy the independent living quarters;

(4) upon leaving the independent living facility, the payor is entitled to receive a payment equal to at least 50 percent of the fair market value at that time of the right to occupy the independent living quarters, the timing of which payment may be contingent on the time when the independent living facility is able to locate a new occupant for such quarters; and

(5) the excess, if any, of the fair market value of the independent living quarters at the time the payor leaves such quarters (less a reasonable amount to cover costs) over the amount paid to the payor is used by an organization described in section 501(c)(3) of such Code to provide housing and related services for needy elderly persons.

(b) Specified Independent Living Facility for the Elderly.—For purposes of this section—

(1) In general.—The term "specified independent living facility for the elderly" means—

(A) the Our Lady of Life Apartments owned by a Missouri not-for-profit corporation with the same name,

(B) the Laclede Oaks Manor owned by the Lutheran Health Care Association of St. Louis, Missouri, and

(C) the Luther Center Northeast owned by the Lutheran Altenheim Society of Missouri.

(2) Requirements.—A facility shall not be considered to be a specified independent living facility for the elderly—

(A) if it is located at any site other than the site which it occupied (or was in the process of occupying through construction) on the date of the enactment of this Act, or

(B) if its ownership is transferred after such date of enactment to a person other than an organization described in section 501(c)(3) of the Internal Revenue Code of 1954.

SEC. 204. EFFECTIVE DATES

(a) Section 201.—

(1) In general.—The amendments made by section 201 shall apply with respect to loans made after the date of enactment of this Act.

(2) Section 7872 not to apply to certain loans.—Section 7872 of the Internal Revenue Code of 1954 shall not apply to loans made on or before the date of the enactment of this Act to any qualified continuing care facility pursuant to a continuing care contract. For purposes of this paragraph, the terms "qualified continuing care facility" and "continuing care contract" have the meanings given such terms by section 7872(g) of such Code (as added by section 201).

(b) Section 202.—The amendment made by section 202 shall apply to contracts entered into after June 30, 1985, in taxable years ending after such date.

(c) Section 203.—The provisions of section 203 shall apply as if included in section 172(a) of the Tax Reform Act of 1984.

Approved October 11, 1985.

House of Representatives
Report No. 99-87
1st Session
[Bracketed numerals indicate official report page numbers]

SIMPLIFICATION OF IMPUTED INTEREST RULES

May 14, 1985.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. Rostenkowski, from the Committee on Ways and Means, submitted the following report to accompany H.R. 2475[1]

The Committee on Ways and Means, to whom was referred the bill (H.R. 2475) to amend the Internal Revenue Code of 1954 to simplify the imputed interest rules of sections 1274 and 483, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

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[1]Public Law 99-121, page 367.

I. SUMMARY

Present Law

The Deficit Reduction Act of 1984 (the "1984 Act", P.L. 98-369) made two basic modifications to the Federal income tax treatment of imputed interest on seller-financing arising from the sale of property. First, the 1984 Act attempted to correct deficiencies in the then-existing imputed interest rules by providing that the amount of imputed interest would be determined by reference to an interest rate tied to the yields on U.S. Treasury obligations. Under these rules, if interest is not stated at a rate at least 110 percent of the average yield on Treasury obligations. Under these rules, if interest is not stated at a rate at least 110 percent of the average yield on Treasury obligations within an appropriate category of maturities (referred to as the applicable Federal rate), then interest is imputed into the transaction at a rate equal to 120 percent of the Federal rate. The effect of imputing interest income into the transaction is not to increase the amount paid by the buyer to the seller, but to recharacterize a portion of the payments (designated as principal by the parties) as interest for Federal income tax purposes.

[2] Second, the 1984 Act expanded the rules dealing with original issue discount to cover many deferred payment obligations arising from the sale of property. The purpose of this change was to ensure that the interest deduction taken by the buyer during a year does not exceed the interest income reported by the seller during that year.

In response to concerns expressed about the complexity of the 1984 Act rules, the Congress passed temporary legislation (called the "stopgap legislation", P.L. 98–612) at the end of the 98th Congress. Under the stopgap legislation, the test rate on the first $2 million of borrowed amounts is 9 percent on sales for exchanges of property occurring before July 1, 1985.

Committee Bill

Imputed interest rules

The committee bill provides that the rate used to determine whether there is adequate stated interest on the first $2 million of seller financing cannot exceed 9 percent. Where the amount of seller financing is greater than $4 million, that rate is 100 percent of the Federal rates. Where the amount of seller financing is between $2 million and $4 million, that rate is a blend of the 9 percent rate on an amount which phases out on a dollar-for-dollar basis as the amount of seller financing exceeds $2 million and 100 percent of the Federal rates on the excess. The $2 million and $4 million threshold amounts are indexed for inflation after 1988.

The committee bill also provides that the rate used to impute interest into the transaction is to be the same as the rate used to determine whether the stated interest is adequate (i.e., there would be no higher penalty rate where inadequate interest is stated). In addition, the Federal rates are to be determined on a monthly basis, and a rate for a month may be used for sales or exchanges occurring in that month and the next two succeeding months. The imputed interest rules will not apply to assumed loans.

Further, in certain transactions where the borrowed amount is not more than $2 million, the committee bill allows the parties to elect to account for interest in the transaction on the cash method of accounting. The election cannot be made if the seller is a dealer in the property sold or uses the accrual method of accounting.

The amendments by the committee bill to the imputed interest rules apply to sales and exchanges after June 30, 1985.

ACRS recovery period for real property

The committee bill extends the ACRS recovery period for real property (other than low-income real property) from 18 years to 19 years. This change generally would be effective for property placed in service after May 8, 1985. However, the longer recovery period would not apply to property placed in service after May 8, 1985, and before January 1, 1987, if the taxpayer entered into a binding contract to purchase or construct the property before May 9, 1985, or construction of the property had begun before May 9, 1985.

[3] II. PRESENT LAW

A. The Original Issue Discount Rules

Treatment of original issue discount as interest

If, in a lending transaction, the bor
rower receives less than the amount t
be repaid at the loan's maturity, the
the difference represents "discount.
Discount performs the same function a
stated interest, i.e., compensation o
the lender for the use of the lender'
money.[1] Code sections 1272 throug
1275 and section 163(e) (the "OI
rules") generally require the holder of
debt instrument issued at a discount t
include annually in income a portion o
the original issue discount ("OID") o
the instrument, and allow the issuer
such an instrument to deduct a corr
sponding amount, irrespective of th
methods of accounting that the hold
and the issuer otherwise use.[2]

Definitions

"Original issue discount" is defin
as the excess of a debt instrument
"stated redemption price at maturit
over its "issue price" (provided su
excess is not less than a certain
minimis amount).

"Issue price" is generally (1) in t
case of a cash loan, the amount b
rowed, (2) in the case of a debt inst
ment that is issued for property wh
either the debt instrument or the pr
erty is publicly traded,[3] the fair mar
value of the property, or (3) if neit
the debt instrument nor the property
changed for it is publicly traded, t
amount determined under section 12
as discussed below.

"Stated redemption price at maturi
includes all amounts payable at ma
rity excluding any interest based o
fixed rate an payable unconditiona
over the life of the debt instrument
fixed intervals no longer than one ye

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[1] *United States* v. *Midland-Ross Corp.*, U.S. 54 (1965); *see also Commissioner* v. *tional Alfalfa Dehydrating & Milling Co.*, U.S. 134 (1974).

[2] Prior to 1982, the OID rules applied only limited class of obligations. The Tax Equity Fiscal Responsibility Act of 1982 and the Act greatly expanded the number and type obligations to which the OID rules apply.

[3] Presently, only stock or securities trade an established securities market are treate publicly traded. However, section 103 o Technical Corrections Act of 1985 (H.R. would grant the Treasury Department author issue regulations treating as publicly traded property "of a kind regularly traded on an e lished market."

Operation of the OID rules

The amount of the OID in a debt instrument, if any, is allocated over the life of the instrument through a series of adjustments to the issue price for each "accrual period" (i.e., each six-month or shorter period ending on the calendar day corresponding to the date of the debt instrument's maturity and the date six months prior to the date of maturity). The adjustment to the issue price for each accrual period is determined by multiplying the "adjusted issue price" (i.e., the issue price increased by adjustments prior to the beginning of the accrual period) by the instrument's yield to maturity, and then subtracting the interest payable during the accrual period. The adjustment to the issue price for any accrual [4] period is the amount of OID allocated to that accrual period. These adjustments reflect the amount of the accrued but unpaid interest on the debt instrument in each period. The holder is required to include this amount as interest income and the issuer is permitted a corresponding interest deduction.[4]

B. Determination of Issue Price in Debt-for-Property Transactions: Section 1274

In general

Section 1274, added by the 1984 Act, performs two roles. First, section 1274 tests the adequacy of stated interest in certain debt instruments issued for nonpublicly traded property and, where stated interest is inadequate, recharacterizes a portion of the principal of the debt instrument as interest. Second, section 1274 prescribes the issue price of the debt instrument. If the issue price so prescribed is less than the debt instrument's stated redemption price at maturity, the application of the OID rules will require the issuer and the holder of the debt instrument to use the accrual method of accounting for any interest (whether stated or imputed) that is not paid currently. Thus, the impact of section 1274 is to require the lender and borrower to account for interest annually in an amount equal to the greater of the stated interest rate or a rate deemed to be adequate (i.e., the "imputation rate," described below).

Subject to certain exceptions, described below, section 1274 determines the issue price of a debt instrument issued in connection with the sale or exchange of property if (1) neither the instrument nor the property received in exchange for the instrument is publicly traded; (2) some or all of the payments under the instrument are due more than six months after the sale; and (3) the stated redemption price at maturity of the instrument exceeds its stated principal amount (if there is adequate stated interest) or its "imputed principal amount" (if there is inadequate stated interest).

Determination of issue price and amount of OID under section 1274

The issue price of an obligation subject to 1274 is the stated principal amount of the instrument unless there is inadequate stated interest. In order to determine whether stated interest is adequate, the stated principal amount of the debt instrument is compared with the "testing amount"—the amount determined by discounting all payments due under the instrument at a prescribed "test rate." An instrument contains adequate stated interest if the stated principal amount is less than or equal to the testing amount.

[5] If a debt instrument does not contain adequate stated interest, section 1274 deems the principal amount (and the issue price) of the instrument to be the "imputed principal amount." The imputed principal amount is the amount determined by discounting all payments due under the instrument using a prescribed "imputation rate," which is higher than the test rate.

In effect, where section 1274 applies, if the debt instrument does not bear interest at a rate at least equal to the prescribed test rate, interest will be imputed at a higher rate. Moreover, if such interest is not unconditionally payable at least annually,[5] the OID rules will require periodic inclusion and deduction of the accrued but unpaid interest. The OID rules also apply if an instrument provides for adequate interest payable at least annually, but also provides for fixed additional amounts of interest that are not paid currently. In such a case, the instrument is deemed to contain OID equal to the additional interest. Pursuant to the OID rules, a portion of this OID is reported as income by the lender and deducted by the borrower currently.[6]

"Test rates" and "imputation rates"

Under section 1274, whether is adequate stated interest in a transaction is determined by reference to an appropriate test rate. The test rate of or a debt instrument subject to section 1274 is the rate in effect on the first day there is a binding contract for the sale or exchange of the property. All test and imputation rates are applied using semiannual compounding.

General rule.—For sales or exchanges after December 31, 1984, of new property eligible for the investment credit, and for all sales or exchanges after June 30, 1985, the test rate is 110 percent of the "applicable Federal rate,"and the imputation rate is 120 percent of the "applicable Federal rate."

Applicable Federal rate.—The applicable Federal rate ("AFR") for a debt instrument is the lower of two published rates, one specified by the 1984 Act and one specified in temporary Treasury regulations. The statutory rate

[4]The premise of the OID rules is that, for Federal income tax purposes, an obligations issued at a discount should be treated like an obligation issued at par requiring current payments of interest. Accordingly, the effect of the OID rules is to treat the borrower as having paid semiannually the lender the interest accruing on the outstanding principal balance of the loan, thereby permitting the borrower to deduct as interest expense and requiring the lender to include in income such interest which has accrued but is unpaid. The lender is then deemed to have lent the accrued but unpaid interest back to the borrower, who in subsequent periods is deemed to pay interest on this amount as well as on the principal balance. This concept of accruing interest on unpaid interest is commonly referred to as the "economic accrual" of interest, or interest "compounding."

[5]As discussed below, the prescribed test rates are based on semiannual compounding. Accordingly, if interest is payable annually, the amount payable must reflect the compounding of the test rate. If interest is payable at intervals more frequent than semiannual, the nominal rate may be adjusted appropriately. For illustration of the adjustments to the prescribed rate based on the intervals at which interest is paid, *see e.g.*, Rev. Rul. 85-58, 1985-1 C.B. 290.

[6]An exception from the accrual accounting requirement is provided for debt issued in connection with sales of property not eligible for the investment credit and used in the active trade or business of farming. This exception applies only if the sale takes place after December 31, 1984, and prior to July 1, 1985, and the borrowed

is based on the weighted average of yields over a period of six months for marketable obligations of the United States Government with a comparable maturity. Such rates are redetermined at six-month intervals for three categories of debt instruments: short-term maturity (three years or less), mid-term maturity (more than three years but not in excess of nine years), and long-term maturity (more than nine years).[7]

[6] The rates determined under the temporary Treasury regulation are intended to reflect more accurately the current marketplace.[8] These rates are computed monthly using the same methodology described above, except that the rates reflect the average yields for one-month periods. In any month, the lower of the six-month rate or the monthly rate is the AFR. However, in cases where the monthly rate for either of the two preceding months is lower than the AFR for a particular month, the test rate for that month is the lower of the two such rates.

Special rule for certain transactions before July 1, 1985.—For sales or exchanges after December 31, 1984, and before July 1, 1985, of property other than new property eligible for the investment credit, the test rate for "borrowed amounts" not exceeding $2 million is 9 percent. The test rate for borrowed amounts exceeding $2 million is a "blend" of 9 percent on the first $2 million and 110 percent of the AFR on the excess. In applying the $2 million limitation, all sales or exchanges that are part of the same transaction (or a series of related transactions) are treated as one transaction, and all debt instruments arising from the same transaction (or a series of related transactions) are treated as one debt instrument. The imputation rate for transactions during this same period is 10 percent for borrowed amounts to $2 million and a blend of 10 percent and 120 percent of the AFR for borrowed amounts exceeding $2 million.

Limitation on principal amount of a debt instrument

Notwithstanding the computation of "issue price" discussed above (and, accordingly, the buyer's basis in the property), the principal amount of any debt instrument under section 1274 in a "potentially abusive situation" is equal to the fair market value of the property sold.[9] This limitation applies whether the stated interest is adequate or inadequate under section 1274.

A potentially abusive situation includes any transaction involving a "tax shelter" (as defined in sec. 6661(b)(2)(C)(ii)). It also includes any other situation that, because of (1) recent sales transactions, (2) nonresource financing, (3) financing with a term beyond the economic life of the property, or (4) other circumstances, is of a type which the Treasury Department by regulation identifies as having a potential for abuse.

Exceptions

Specific exceptions are provided for certain debt instruments that otherwise would be subject to section 1274. However, these debt instruments may be subject to the rules of section 483. As discussed below, section 483 tests the adequacy of interest in a debt instrument without requiring annual inclusion and deduction of ac- [7] crued but unpaid interest. Debt instruments that are expected from section 1274 are as follows:

Personal-use property.—Issuers (but not holders) of debt instruments issued in exchange for property, substantially all of which will not be used by the issuer in a trade or business or held by the issuer for the production or collection of income, are excepted from section 1274. Accordingly, a cash-metho issuer of such an obligation may clai interest deductions only for amounts stated interest actually paid during th taxable year.

Annuities.—Section 1274 does no apply to an annuity to which section 7 applies and the liability for which d pends in whole or in substantial part the life expectancy of any individua In addition, section 1274 does not a ply to any annuity (whether or not d pendent upon life expectancy) issue by an insurance company (subject tax under Subchapter L), provided t annuity is issued (1) in a transaction which only cash or another annui contract meeting the requirements this exception is exchanged for the a nuity, (2) upon exercise of an electi under a life insurance policy by a ben ficiary thereof, or (3) in a transacti involving a qualified pension or e ployee benefit plan.

Patents.—An exception is provid for payments attributable to a trans of a patent, provided the transfer is gible for capital gain treatment un section 1235 and such payments contingent upon the productivity, u or disposition of the patent. Thus, exception does not apply in the case a deferred lump-sum amount paya for a patent.

Farms.—Section 1274 does not ply to debt instruments received by individual, estate, or testamentary tr by a small business corporation (as fined in sec. 1244(c)(3)), or by cer partnerships[10] in exchange for a fa This exception applies only if the s price does not exceed $1 million.[11]

Principal residences—Debt ins ments received by an individual as sideration for the sale or exchang that individual's principal reside (within the meaning of sec. 1034) not subject to section 1274, regard

amount does not exceed $2 million. Interest on such debt is accounted for by both the borrower and the lender on the cash method of accounting.

[7]Appropriate adjustments to the rates are to be made for application to debt instruments, the interest on which is wholly or partly exempt from tax (sec. 1288).

[8]The mechanism provided by the temporary regulations is intended to respond to a problem that may exist where interest rates decline after the period in which the Federal rates were determined.

[9]The principal amount of the note is reduced to reflect the fair market value of other consideration involved in the transaction. This provision prevents both overstatement *and* understatement of the buyer's basis in the property. The purpose of the latter restriction is to prevent the intentional overstatement of OID. A taxpayer might be motivated to overstate the interest element of a sale, for example, if the property involved in the sale were nondepreciable or the seller were not subject to U.S. tax on interest income.

[10]That is, those partnerships whose capi not in excess of the limits specified in 1244(c)(3).

[11]Sales and exchanges that are part of the transaction or a series of related transactio treated as one sale or exchange, in order t vent taxpayers from avoiding the $1 million tation by dividing what is in substance a transaction into two or more smaller transac The exception for farms as well as the exce following are nevertheless subject to sec. 4 more fully discussed in the text below.

of the amount involved in the transaction.

Total payments not exceeding $250,000—Section 1274 does not apply to any debt instrument given in exchange for property if the sum of (1) the payments due under the instrument (whether designated principal or interest) and under any other debt instrument given in the transaction, and (2) the fair market value of any other consideration given in the transaction, does not exceed $250,000.[12]

Land transfers between related persons.—Section 1274 does not apply to an instrument to the extent that section 483(f), relating to certain sales of land between related parties, applied.

[8] C. Measurement of Principal and Interest in Transactions Not Subject to the OID Rules: Section 483

In general

Section 483 generally applies to nonpublicly traded debt instruments given in exchange for nonpublicly traded property where such debt instruments are not subject to section 1274. Under section 483, an instrument is tested for adequate stated interest in the same manner, and using the same test rates, as under section 1274. Where stated interest is inadequate, section 483 recharacterizes a portion of the principal amount of the instrument as interest which, in general, is equal to the additional amount of OID that section 1274 would impute.[13]

However, unlike section 1274, section 483 does not require inputed interest (or stated interest) to be accounted for on an accrual basis. Stated interest on a debt instrument subject to section 483 is accounted for under the taxpayer's usual method of accounting. Imputed interest is accounted for by cash-method taxpayers when the payments, portions of which are recharacterized as interest by section 483 are made, or by accrual-method taxpayers when such payments are due. The portion of the imputed interest that is allocated to a payment is that portion of the total imputed interest which, in a manner consistent with the method of computing interest under the OID rules, is properly allocable to such payment.

Exceptions

Excepted transactions.—Section 483 contains the same exceptions for sales of personal-use property, annuities, and patents that apply to section 1274. In addition, section 483 does not apply where the sales price of the property does not exceed $3,000.

Lower test rates.—In the case of a sale after June 30, 1985, of a principal residence where the purchase price does not exceed $250,000 or of farm land where the price does not exceed $1 million (where such sale would qualify for exception from section 1274), the test rate may not exceed 9 percent, and imputation rate may not exceed 10 percent. If the purchase price of a principal residence exceeds $250,000, these limits apply to the portion of the deferred payments that $250,000 bears to the sales price; the rates based on the AFR apply to the remainder. In addition, for sales or exchanges of land between an individual and that individual's brothers, sisters, spouse, ancestors or lineal descendants, the test rate under section 483 may not exceed 6 percent. This preferential rate applies only to the extent that the sales price of the land, and the sales price of all prior sales price of the land, and the sales price of all prior sales of land between the same individuals in a calendar year, does not exceed $500,000.

[9] D. Regulatory Authority Relating to Debt-For-Property Transactions

The Treasury Department has authority to issue regulations dealing with the treatment of transactions involving varying interest rates, put or call options, indefinite maturities, contingent payments, assumptions of debt instruments not specifically dealt with in the statute, and other circumstances. The regulatory authority granted to the Treasury Department contemplates possible modification of the generally applicable rules where appropriate to carry out the purposes of the statute, including the provision of exceptions for transactions not likely to significantly reduce the tax liability of the purchaser by reason of overstatement of the basis of the acquired property.

Pursuant to its regulatory authority, the Treasury Department has provided the monthly rates in order to address the problems that may arise where the statutorily determined rates are significantly higher than prevailing market interest rates.

E. Assumptions of Debt in Connection With the Sales of Property

Neither section 483 nor section 1274 applies to the following debt obligations assumed in connection with the sale or exchange of property, or to debt obligations which property is taken subject to, provided that the terms and conditions of the obligation are not modified in connection with the sale:

Pre-October 16, 1984 obligations

Loans made on or before October 15, 1984, and assumed after December 31, 1984, in connection with a sale or exchange of property, are not subject to section 483 or section 1274 by reason of such assumption.[14] This exception does not apply, however, if the purchase price of the property exceeds $100 million.

Residences

Loans assumed in connection with a sale of a residence by an individual, estate, or testmentary trust are exempt from sections 483 and 1274 if either (1) at the time of the sale, the property was the seller's (or if applicable, the decedent's) principal residence (within the meaning of sec. 1034) or (2) during the two-year period prior to the sale, no substantial portion of the property was of a character subject to an allowance for depreciation. Thus, an assumption of a loan in connection with the sale of a principal residence, or of a vacation home on which a taxpayers may not claim depreciation (e.g., by reason of sec. 280A), generally is not subject to testing for unstated interest under sections 483 or 1274. This exception does not apply, however, to a sale of prop-

[12]This exception is subject to an aggregation rule similar to that provided under the farm sale exception.

[13]For certain transactions, lower test and imputation rates are provided. These transactions are described in the text below.

[14]The exceptions relating to assumptions of loans also apply to loans which property may be taken subject to:

erty that was at any time held by the seller for sale to customers in the ordinary course of business.

[10] *Farms*

Neither sections 483 or 1274 apply to loans assumed in connection with a sale by a "qualified person" of real property used as a farm (within the meaning of sec. 6420(c)(2)) at all times during the three-year period prior to the sale. The exception also applies to loans assumed in connection with the sale of tangible personal property used by the seller of such a farm in the active conduct of a farming business that is also sold in connection with the sale of such a farm for use by the buyer in the active conduct of a farming business. The term "qualified person" includes an individual, estate, or testamentary trust, or a corporation or partnership having 35 or fewer shareholders or partners immediately prior to the sale or exchange, owning at least a 10-percent interest in the property sold.

Trades or businesses

Loans assumed in connection with a sale by a "qualified person" of a trade or business are exempt from sections 483 and 1274. Trade or business has the same meaning as under section 355, except that the rental of real estate under no circumstances qualifies as an active business for this purpose. For purposes of this exception, the term "qualified person" has the same meaning as in the exception for assumptions in connection with the sale of farm properties except that the sale must constitute a disposition of the seller's entire interest in the trade or business and in all substantially similar trades or businesses.

An exception is also provided for a sale of real property used in an active trade or business (as defined above) by someone who would be a qualified person but for the fact that this entire interest in the trade or business is not being sold. Thus, for example, loans assumed in connection with a casual sale by a sole proprietor of real property used in his business could be exempt from sections 1274 and 483.

The trade or business property exception does not apply to a sale of property qualifying under the farm exception, or to property that is new property eligible for the investment credit in the buyer's hands.

F. Cost Recovery Deductions for Real Property

In general, domestic real property placed in service after March 15, 1984, and qualifying as recovery property, may be depreciated on an accelerated basis under ACRS over an 18-year period, under tables of recovery percentages prescribed by the Treasury Department. These tables reflect a "mid-month" convention for property placed in service after June 22, 1984. Taxpayers may also elect to depreciate such property on a straight-line basis over 18, 35, or 45 years. The recovery period under ACRS for low-income housing described in sections 1250(a)(1)(B)(i), (ii), (iv) is 15 years and no mid-month convention is used.

Under transitional rules provided by the 1984 Act, property placed in service after March 15, 1984, pursuant to binding contracts entered into, or where construction was commenced by or for the taxpayer, prior to March 16, 1984, may be eligible for a 15-year [11] recovery period. Special rules under the 1984 Act are also provided relating to components of real property placed in service prior to March 16, 1984, that are placed in service on or after the date.[15]

III. REASONS FOR CHANGE

In general

The imputed interest rules of the 1984 Act have been perceived as complex in several respects. The changes made by the committee bill attempt to simplify the imputed interest rules, while retaining the basic purposes of the 1984 legislation.

The imputed interest rate

The committee believes that taxpayers entering into smaller transactions should not have to keep track of the fluctuating imputed interest rates prescribed by the 1984 Act. Accordingly, the committee bill provides a single maximum test rate of 9 percent for transactions where the amount of seller financing does not exceed $2 million. In addition, in order not to create unfairness where the size of the transaction is slightly above the $2 million threshold amount, the committee bill phases out the 9-percent rate on a dollar-for-dollar basis on amounts between $2 million and $4 million.

The definition of the AFR provided by the Act was intended to be a current measure of minimum borrowing rates for a given range of maturities. The mechanism for determining the AFR under the 1984 Act (and the temporary Treasury regulations), however, lags somewhat behind the market. For example, where interest rates are falling rapidly, it is possible for the appropriate borrowing rates for a particular transaction to be slightly lower than 110 percent of the AFR. Accordingly, the committee believes that it is appropriate to reduce the imputed interest rate to 100 percent of the AFR.

The committee believes that an imputed interest rate of 100 percent of the AFR (for transactions not eligible for the lower fixed test rate) is a fair minimum rate and one which will not impose hardships on taxpayers. In recognition that there might be certain isolated circumstances in which a different rate would be more appropriate, the committee bill grants the Treasury Department authority to issue regulations that would permit taxpayers to demonstrate that a lower rate is more accurate in proper cases.

The committee also believes that it is an unnecessary and needless complication to maintain the dual mechanism for determining the AFR that is currently provided by the 1984 Act and temporary Treasury regulations. The mechanism provided by the regulations has worked adequately to provide a rate which is current, yet because of the three-month period that a taxpayer may use the rate, is stable. Consequently, the committee bill eliminates the six-month rate.

Finally, the committee believes that the higher imputation provided by the 1984 Act often acted as a penalty for uninformed taxpayers. Knowledgeable taxpayers could always avoid the higher im- [12] putation rate by providing for stated interest at a lower test rate. Accordingly, the committee bill eliminates the higher imputation rate

[15] Sec. 168(f)(1).

Method of accounting

The 1984 Act attempted to prevent mismatching of interest income and interest deductions by requiring both the buyer and the seller to account for the interest in the transaction on the accrual method of accounting. Nevertheless, calculating and accounting for accrued but unpaid interest may impose hardship on taxpayers who might have to report taxable income in advance of receiving cash with which to pay the tax. This aspect is inconsistent with the committee's intention to relieve smaller transactions from complexity. Therefore, the committee bill permits taxpayers in certain smaller transactions to elect to use the cash receipts and disbursements method of accounting for interest income and expense, provided that both buyer and seller jointly agree to do so.

Assumptions

While the changes that the 1984 Act made in the imputed interest rules were in large part intended to stop abuses that result from the manipulation of principal and interest in a debt instrument arising from a seller-financed sale of property, many taxpayers have argued that the assumption of a debt instrument does not present the same potential for abuse as does a seller- financed debt instrument because where a debt instrument is assumed and its terms are not modified in connection with the transaction, there is no opportunity for the parties to manipulate principal and interest on the loan. Accordingly, under the committee bill, the imputed interest rules generally will not apply to assumptions of loans.

ACRS recovery period for real property

The committee believes that, in light of the current budget deficit of the Federal Government, there should be an offset for the revenue loss resulting from the changes the committee bill makes to the imputed interest rules (much of which results from transactions involving real property.) The committee also believes that the useful life of most real property exceeds 18 years and that an increase in the cost recovery period for real property would more correctly measure the income from real property. Accordingly, to maintain revenue neutrality, the committee bill would extend the ACRS recovery period of real property (other than low-income housing) from 18 years to 19 years.

IV. EXPLANATION OF THE BILL

A. The Imputed Interest Rate

In general

The committee bill makes four basic changes to the imputed interest rates. First, the committee bill reduces the test rate from 110 percent of the AFR to 100 percent of the AFR. Second, the committee bill provides for lower imputed interest rates for certain smaller transactions. Third, the committee bill provides that the imputa-
[13] tion rate would be the same as the test rate (i.e., there would be no higher "penalty rate" where inadequate interest is stated). Finally, the committee bill would revise the computation of the AFR from a semiannual rate to a monthly rate.

Lower overall imputed interest rate

Under the committee bill, the imputed interest rate (i.e., the test rate and the imputation rate) is reduced to 100 percent of the AFR.

Lower imputed interest rates for certain smaller transactions

The committee bill places a limit on the imputed interest rates in smaller transactions which do not involve new property eligible for the investment tax credit. Under these rules, where the amount of seller financing[16] does not exceed $4 million, the committee bill provides that the imputed interest rate cannot exceed 9 percent.[17] Where the amount of seller financing exceeds $2 million but is less than $4 million, the imputed interest rate is a "blend" of 9 percent on a specified portion of the seller financing and the 100 percent of the AFR on the remainder. The portion of the seller-financing eligible for the 9 percent rate is equal to $2 million reduced dollar-for-dollar by the amount of seller financing over $2 million. For example, if the amount of seller financing were $2.5 million, the emputed interest rate would be the weighted average of 9 percent on $1.5 million (i.e., $2 million reduced by the excess of $2.5 million over $2 million) and the AFR on the remaining $1 million.[18] where the amount of seller financing is $4 million or more, the imputed interest rate is the equal to 100 percent of the AFR. The $2 million and $4 million "thresholds" will be indexed for inflation beginning after 1988.

For sales of new property eligible for the investment credit, the imputed interest rate for a seller-financed debt instrument is equal to the AFR regardless of the amount of seller financing.

Elimination of the penalty rate

Under the committee bill, the imputation rate for a debt instrument that fails to state adequate interest will be the same as the test rate for that instrument. Accordingly, there is only one "imputed interest rate" for a transaction and there is not separate "penalty rate" where a debt instrument does not state adequate interest for any reason.

Determination of the applicable Federal rate

Under the committee bill, the sole mechanism for determining the AFR will be the one currently prescribed by the temporary Treasury regulations. The alternative mechanism under present law for determining the six-month rate prescribed by the 1984 Act will be eliminated.
[14] Under these revised rules, the AFR will be computed using the same methodology as under present law, except that the rates will be determined on a monthly basis and the rate will reflect the average yields for one-month periods. In addition, the AFR for a particular month may be used as the imputed interest rate for that month and the next two succeeding months.

Regulatory authority

Aggregation rules.—The Committee bill authorizes the Treasury Department to issue regulations specifying the cir-

[16]The amount of seller financing is measured by the stated principal amount of the seller-financed debt instrument.

[17]As under prior law, all rates are compounded semiannually.

[18]The weighted average in the example may be computed as follows, assuming an AFR of 11.5 percent: 9 percent times 0.6 (i.e., $1.5 million divided by $2.5 million) plus 11.5 percent times 0.4 (i.e., $1.0 million divided by $2.5 million) equals 10 percent.

cumstances in which transactions will be treated as "part of the same transaction of related transactions" for the purpose of applying the $2 million and $4 million limitations. These regulations will address transactions involving multiple sellers, multiple buyers, "pass-through" entities, and one transaction structured as a series of small transactions. It is anticipated that the regulations will aggregate transactions in which multiple buyers or multiple sellers are acting in concert. The committee intends, however, that these regulations would provide that multiple sales by a taxpayer who is a dealer in the property sold, to unrelated buyers in otherwise unrelated transactions (such as typically occurs when a home builder sells homes in unrelated transactions to different home buyers) would not be aggregated.

Lower rates.—The committee bill also provides that the Treasury Department is authorized to issue regulations under which taxpayers would be permitted to demonstrate that, in appropriate circumstances, a rate lower than the AFR provided by the statute, but calculated according to the same principles as the AFR, is a more appropriate imputed interest rate for a particular debt instrument. For example, it may be appropriate to use a lower rate where the borrower can demonstrate that it can borrow in the open market at a rate less than the AFR applicable to that maturity to the debt instrument for which the imputed interest rate is to be applied.

Coordination with other Code provisions.—The Treasury Department is authorized to issue regulations regarding the relationship of the imputed interest provisions to other Code provisions. The committee intends to limit the benefit of the lower test rate (provided by section 1274A) to bona fide sales of property between unrelated parties. Accordingly, the regulations may provide that section 1274A would not apply to certain transactions undertaken to avoid other provisions of the Code that require an arm's-length interest rate. For example, where a corporation purchases $2 million of nonpublicly traded debt yielding a rate equal to the AFR and sells that debt obligation to its shareholders for a note paying interest at 9 percent, the committee understands that regulations would provide that there would be additional interest income to the corporation. The committee anticipates that the Treasury Department will exercise the regulatory authority granted by the 1984 Act to provide rules under which contingent payments (e.g., payments based on future sales or rental receipts) may be taken into account in determining whether or not a debt instrument has adequate stated interest in transactions that would not thereby be subject to abuses. In addition, the committee intends that the Treasury Department's 1984 Act regulatory authority will be exer- [15] cised with regard to situations where the OID rules are avoided a result of prearranged or systematic discounting of seller-financed debt instruments.

B. Method of Accounting

The "cash-cash" election

The committee bill provides that, in the case of certain debt instruments that otherwise would be subject to section 1274, interest income and expense arising from such debt instruments may be accounted for on the cash receipts and disbursements method of accounting. To be eligible for for such treatment, (1) the stated principal amount of the debt instrument cannot exceed $2 million, (2) the debt instrument must arise from the sale of property by a cash-basis taxpayer who is not a dealer in the type of property sold, and (3) the lender and the borrower must jointly elect such treatment.[19] A debt instrument meeting these requirements is to be known as a "cash-method debt instrument."

Transfers and assumptions of cash-method debt instruments

Special rules are provided relating to the treatment of taxpayers who are the successors to either the issuer or holder of a cash-method debt instrument. Generally, such a successor shall also be required to use the cash receipts and disbursements method of accounting for interest income and expense arising from the cash-method debt instrument. Accordingly, where an accrual-metho taxpayer assumes the liability on cash-method debt instrument, that ta payer must use the cash method to ac count for interest expense arising fro the instrument. An exception is pr vided where a cash-method debt instr ment is transferred to a subsequen holder who uses the accrual method accounting. In this case, the exceptio requires the subsequent holder to co tinue to use his normal method of a counting (i.e., to use the accru method).

Regulatory authority

The Treasury Department is autho ized to issue regulations prescribin rules to prevent abuses of the speci treatment afforded to cash-method de instruments. The committee intend that the delegation of regulatory autho ity will be exercised only to preve abuse situations.

One situation that such regulatio may address is the timing of deductio for interest on indebtedness incurred continued to acquire or carry a cas method debt instrument. Another situ tion that may be addressed is o where a cash-method debt instrume remains outstanding when the propert the initial sale of which gave rise to t cash-method debt instrument, is reso in a transaction involving a selle financed debt instrument.

A third situation which the regul tions may address relates to the trea ment of transfers of cash-method de instruments. It is anticipated that the regulations will clarify existing la regard- [16] ing (1) the amount a character of gain realized on dispositi of a cash-method debt instrumen (2) the allocation of payments on t debt instrument between income a recovery of basis for a subseque holder, and (3) the timing of intere deductions for, and the allocation of terest deductions between, the initial suer and a taxpayer who assumes issuer's obligations on a cash-meth debt instrument.[20]

[19]The Committee intends that, until regulations are issued specifying a different method of election, the parties can make the election by so indicating in their respective tax returns and stating the election clearly in the debt instrument.

[20]*See, e.g., United States* v. *Midland R Corp.* 381 U.S. 54 (1965); Treas. Reg. 1.61-7; Code secs. 1276, *et seq.*

C. Assumptions

Under the committee bill, if an existing debt instrument is assumed in connection with the sale or exchange of property (or if the property is acquired subject to an existing debt instrument), section 1274 and section 483 do not apply to such existing debt instrument by reason of such assumption (or acquisition) unless the terms of the existing debt instrument are modified in connection with the transaction or the nature of the transaction is changed.[21] If only minor modifications are made in the terms of the loan, the committee does not intend that the imputed interest rules will be applied.

Under temporary Treasury regulations, for installment reporting purposes, a so-called wrap-around debt instrument may be treated like an assumption of the so-called "wrapped" (or underlying debt). However, many taxpayers have taken the contrary position. The committee believes that a wrap-around debt should be treated consistently for purposes of the installment reporting and imputed interest rules. The committee does not wish to address the proper treatment of wrap-around debt for installment reporting at this time. Moreover, the committee wishes to avoid the situation where the seller takes the position that the wrap-around debt does not result in immediate taxation, while the buyer takes the position that the entire amount of the wrap-around debt is exempt from the imputed interest rules. Accordingly, until and unless it is ultimately settled that a wrap-around debt instrument is treated as an assumption for installment reporting purposes, the committee intends that the exception in the committee bill relating to assumptions should not apply to wrap-around debt instruments.

D. Accelerated Cost Recovery System

Under the committee bill, the minimum recovery period for domestic real property qualifying as recovery property is increased from 18 years to 19 years. This change in the recovery period does not affect the ACRS provisions relating to low-income housing.

[17] E. Effective Dates

Imputed interest rules

The provisions of the committee bill relating to the amendment of the imputed interest rules are effective for sales or exchanges occurring after June 30, 1985.

ACRS recovery period for real property

The provision of the committee bill relating to the ACRS recovery period for real property is generally effective for property placed in service after May 8, 1985. Transitional rules similar to those under the 1984 Act are provided for property that is placed in service after May 8, 1985, and before January 1, 1987, where there was a binding contract to construct or acquire the property, or where construction was begun by or for the taxpayer before May 9, 1985. Special rules apply to components placed in service after May 8, 1985.[22]

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Senate Report No. 99-83
1st Session
Bracketed numerals indicate official report page numbers

SIMPLIFICATION OF IMPUTED INTEREST RULES

June 13 (legislative day, June 3), 1985

Mr. Packwood from the Committee on Finance, submitted the following report to accompany H.R. 2475.[1]

The Committee on Finance, to which was referred the bill (H.R. 2475) to amend the Internal Revenue Code of 1954 to simplify the imputed interest rules of sections 1274 and 483, and for other purposes, having considered the same, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

I. SUMMARY

Present Law

The Deficit Reduction Act of 1984 (the "1984 Act", P.L. 98-369) made two basic modifications to the Federal income tax treatment of interest on seller-financed obligations arising from the sale of property. First, the 1984 Act attempted to correct deficiencies in the then existing imputed interest rules by providing that the amount of unstated interest in a transaction would be determined by reference to an interest rate tied to the yields on U.S. Treasury obligations. Under the imputed interest rules as modified by the Act, if interest is not stated at a rate at least 110 percent of the "applicable Federal rate"—the average yield on Treasury obligations within an appropriate category of maturities—then interest is imputed into the transaction at a rate equal to 120 percent of the Federal rate. The effect of imputed interest income into a transaction is not to increase the amount paid by the buyer to the seller over the term of the loan, but to recharacterize a portion of the [2] payments (designated as principal by the parties) as interest for Federal income tax purposes.

Second, the 1984 Act expanded the rules dealing with original issue discount to cover many deferred-payment obligations arising from the sale of property. The purpose of this change was to ensure that the interest deduction taken by the buyer during a year essentially equals the amount of interest income are reported by the seller during the year.

The 1984 Act also modified the tax treatment of certain loans with below-market interest rates, other than those subject to the imputed interest rules. Generally, the 1984 Act would treat such "below-market loans" as loans bearing a market rate of interest, accompanied by a payment from the lender to the borrower.

In response to concerns expressed about the complexity of the 1984 Act rules, the Congress passed temporary legislation (called the "stopgap legislation", P.L. 98-612) at the end of the 98th Congress. Under the stopgap legislation, in seller-financed transactions the test rate on the first $2 million of borrowed amounts is 9 percent on sales and exchanges of property occurring before July 1.

[21]The committee intends that the nature of the transaction is to be considered changed if, for example, the loan which is to be assumed arose in a transaction that was excepted from section 483, but the subsequent transaction does not qualify for the exception. *See, e.g.*, Treas. Reg. sec. 1.483-1(f)(6)(iv) (Example 4).

[1]Public Law 99-121, page 367.

[22]Sec. 168(f)(1).

Committee Bill

Imputed interest rules

The Committee bill provides that the rate used to test the adequacy of stated interest on the first $2 million of seller financing cannot exceed 9 percent. Where the amount of seller financing is greater than $4 million, the rate is 100 percent of the applicable Federal rate. Where the amount of seller financing is between $2 million and $4 million, that rate is a blend of the 9 percent rate on an amount which phases out on a dollar-for-dollar basis as the amount of seller financing exceeds $2 million and 100 percent of the applicable Federal rate on the excess. The $2 million and $4 million threshold amounts are indexed for inflation after 1988. In certain circumstances, the discount rate used in determining the amount of imputed interest in a transaction is limited if the applicable Federal rate exceeds 12 percent.

The Committee bill also provides that the rate used to impute interest in a transaction in which in adequate interest is stated). In addition, the Federal rates will be determined on a monthly basis, and a rate for a month may be used for sales or exchanges occurring in that month and the next two succeeding months. The imputed interest rules will not apply to assumed loans.

Further, in certain transactions where the amount of seller-financing is not more than $2 million, the Committee bill allows the parties to elect to account for interest in the transaction on the cash method of accounting. The election cannot be made if the seller is a dealer in the property sold or uses the accrual method of accounting.

The amendments by the Committee bill to the imputed interest and original issue discount rules apply to sales and exchanges after June 30, 1985.

[3] With the exception of the limitation on the discount rate where the applicable Federal rate exceeds 12 percent, identical provisions are contained in the House bill.

Below-market loan rules

The Committee bill clarifies the application of the below-market loan rules for certain loans made to "continuing care facilities" pursuant to "continuing care contracts." In general, a continuing care facility is a combination of a retirement community and a facility for the provision of long-term nursing care. The continuing care contract provides a retired individual or couple with residential accommodations, ongoing personal care, and an insurance-type arrangement under which long-term nursing care will be provided when necessary without substantial additional cost to the retirees. In general, where a loan in such an arrangement was made on or prior to the date of enactment, or where the loan is made during or after the calendar year in which the lender reaches age 65 and the amount of the loan does not exceed $90,000, the loan is excepted from the below-market loan rules. Loans made after the date of enactment to continuing care facilities pursuant to continuing care contracts, will be subject to the below-market loan rules to the extent the principal amount of the loan exceeds $90,000 or where the lender does not meet the age requirement.

The Committee bill also modifies the below-market loan rules relating to employer-employee loans the proceeds of which are used by the employee to purchase a principal residence in connection with certain changes in employment. Under the Committee bill, the rate used to determine whether such a loan bears adequate interest is the applicable Federal rate for the date on which a written contract to purchase the principal residence is entered into, rather than at the time the loan is made. This modification is effective for loans made with respect to purchase contracts entered into after June 30, 1985.

ACRS recovery period for real property

The Committee bill extends the ACRS recovery period for real property (other than low-income housing) from 18 years to 19 years. This change generally will be effective for property placed in service after May 8, 1985. However, the longer recovery period will not apply to property placed in service after May 8, 1985, and before January 1, 1987, if the taxpayer entered into a binding contract to purchase or construct the property before May 9, 1985, or construction of the property began before May 9, 1985. The House bill contains an identical provision.

[4] II. PRESENT LAW

A. The Original Issue Discount Rules

Treatment of original issue discount as interest

If the borrower receives less in a lending transaction than the amount to be repaid at the loan's maturity, then the difference represents "discount." Discount performs the same function as stated interest, i.e., compensation of the lender for the use of the lender's money.[1] Code sections 1272 through 1275 and section 163(e) (the "OID rules") generally require the holder of a debt instrument issued at a discount to include annually in income a portion of the original issue discount ("OID") on the instrument, and allow the issuer of such an instrument to deduct a corresponding amount, irrespective of the methods of accounting that the holder and the issuer otherwise use.[2]

Definitions

"Original issue discount" is defined as the excess of a debt instrument's "stated redemption price at maturity" over its "issue price" (provided such excess is not less than a certain *de minimis* amount).

"Issue price" is generally (1) in the case of a cash loan, the amount borrowed, (2) in the case of a debt instrument that is issued for property where either the debt instrument or the property is publicly traded,[3] the fair market value of the property, or (3) if neither the debt instrument nor the property exchanged for it is publicly traded, the amount determined under section 1274, as discussed below.

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[1] *United States* v. *Midland-Ross Corp.*, 381 U.S. 54 (1965); *see also Commissioner* v. *National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134 (1974).

[2] Prior to 1982, the OID rules applied only to a limited class of obligations. The Tax Equity and Fiscal Responsibility Act of 1982 and the 1984 Act greatly expanded the number and types of obligations to which the OID rules apply.

[3] Presently, only stock or securities traded on an established securities market are treated as publicly traded. However, section 103 of the proposed Technical Corrections Act of 1985 (S. 814) would grant the Treasury Department authority to issue regulations treating as publicly traded other property "of a kind regularly traded on an established market."

"Stated redemption price at maturity" includes all amounts payable at maturity excluding any interest based on a fixed rate and payable unconditionally over the life of the debt instrument at fixed intervals no longer than one year.

Operation of the OID rules

The amount of the OID in a debt instrument, if any, is allocated over the life of the instrument through a series of adjustments to the issue price for each "accrual period" (i.e., each six-month or shorter period ending on the calendar day corresponding to the date of the debt instrument's maturity and the date six months [5] prior to the date of maturity). The adjustment to the issue price for each accrual period is determined by multiplying the "adjusted issue price" (i.e., the issue price increased by adjustments prior to the beginning of the accrual period) by the instrument's yield to maturity, and then subtracting the interest payable during the accrual period. The adjustment to the issue price for any accrual period is the amount of OID allocated to that accrual period. These adjustments reflect the amount of the accrued but unpaid interest on the debt instrument in each period. The holder is required to include this amount as interest income and the issuer is permitted a corresponding interest deduction.[4]

B. Determination of Issue Price in Debt-for-Property Transactions: Section 1274

In general

Section 1274, added by the 1984 Act, performs two roles. First, section 1274 tests the adequacy of stated interest in certain debt instruments issued for nonpublicly traded property and, where stated interest is inadequate, recharacterizes a portion of the principal of the debt instrument as interest. Second, section 1274 prescribes the issue price of the debt instrument. If the issue price so prescribed is less than the debt instrument's stated redemption price at maturity, the application of the OID rules will require the issuer and the holder of the debt instrument to use the accrual method of accounting for any interest. (whether stated or imputed) that is not paid currently. Thus, the impact of section 1274 is to require the lender and borrower to account for interest annually in an amount equal to the greater of the stated interest rate or a rate deemed to be adequate (i.e., the "imputation rate," described below).

Subject to certain exceptions, described below, section 1274 determines the issue price of a debt instrument issued in connection with the sale or exchange of property if (1) neither the instrument nor the property received in exchange for the instrument is publicly traded; (2) some or all of the payments under the instrument are due more than six months after the sale; and (3) the stated redemption price at maturity of the instrument exceeds its stated principal amount (if there is adequate stated interest) or its "imputed principal amount" (if there is inadequate stated interest).

Determination of issue price and amount of OID under section 1274

The issue price of an obligation subject to section 1274 is the stated principal amount of the instrument unless there is inadequate stated interest. In order to determine whether stated interest is adequate, the stated principal amount of the debt instrument [6] is compared with the "testing amount"—the amount determined by discounting all payments due under the instrument at a prescribed "test rate." An instrument contains adequate stated interest if the stated principal amount is less than or equal to the testing amount.

If a debt instrument does not contain adequate stated interest, section 1274 deems the principal amount (and the issue price) of the instrument to be the "imputed principal amount." The imputed principal amount is the amount determined by discounting all payments due under the instrument using a prescribed "imputation rate." which is higher than the test rate.

In effect, where section 1274 applies, if the debt instrument does not bear interest at a rate at least equal to the prescribed test rate, interest will be imputed at a higher rate. Moreover, if such interest is not unconditionally payable at least annually,[5] the OID rules will require periodic inclusion and deduction of the accrued but unpaid interest. The OID rules also apply if an instrument provides for adequate interest payable at least annually, but also provides for fixed additional amounts of interest that are paid currently. In such a case, the instrument is deemed to contain OID equal to the additional interest. Pursuant to the OID rules, a portion of this OID is reported as income by the lender and deducted by the borrower currently.[6]

"Test rates" and "imputation rates"

Under section 1274, whether there is adequate stated interest in a transaction is determined by reference to an appropriate test rate. The test rate for a debt instrument subject to section 1274 is the rate in effect on the first day there is a binding contract for the sale or exchange of the property. All test and imputation rates are applied using semiannual compounding.

General rule.—For sale or exchange after December 31, 1984, of new property eligible for the investment credit, and for all sales or exchanges after

[4]The premise of the OID rules is that, for Federal income tax purposes, an obligation issued at a discount should be treated like an obligation issued at par requiring current payments of interest. Accordingly, the effect of the OID rules is to treat the borrower as having paid semiannually the lender the interest accruing on the outstanding principal balance of the loan, thereby permitting the borrower to deduct as interest expense and requiring the lender to include in income such interest which has accrued but is unpaid. The lender is then deemed to have lent the accrued but unpaid interest back to the borrower, who in subsequent periods is deemed to pay interest on this amount as well as on the principal balance. This concept of accruing interest on unpaid interest is commonly referred to as the "economic accrual" of interest, or interest "compounding."

[5]As discussed below, the prescribed test rates are based on semiannual compounding. Accordingly, if interest is payable annually, the amount payable must reflect the compounding of the test rate. If interest is payable at intervals more frequent than semiannual, the nominal rate may be adjusted appropriately. For illustration of the adjustments to the prescribed rate based on the intervals at which interest is paid, *see e.g.*, Rev. Rul. 85-58, 1985-1 C.B. 290.

[6]An exception from the accrual accounting requirement is provided for debt issued in connection with sales of property not eligible for the investment credit and used in the active trade or business of farming. This exception applies only if the sale takes place after December 31, 1984, and prior to July 1, 1985, and the borrowed amount does not exceed $2 million. Interest on such debt is accounted for by both the borrower and the lender on the cash method of accounting.

June 30, 1985, the test rate is 110 percent of the "applicable Federal rate," and the imputation rate is 120 percent of the "applicable Federal rate."

Applicable Federal rate.—The applicable Federal rate ("AFR") for a debt instrument is the lower of two published rates, one specified by the 1984 Act and one specified in temporary Treasury regulations. The statutory rate is based on the weighted average of yields over a period of six months for marketable obligations of the Untied States Government with a comparable maturity. Such rates are redetermined at six-month intervals for three categories of debt instruments: short-term maturity (three years or less), mid-term [7] maturity (more than three years but not in excess of nine years), and long-term maturity (more than nine years).[7]

The rates determined under the temporary Treasury regulations are intended to reflect more accurately the current marketplace.[8] These rates are computed monthly using the same methodology described above, except that the rates reflect the average yields for one-month periods. In any month, the lower of the six-month rate of the monthly rate is the AFR. However, in cases where the monthly rate for either of the two preceding months is lower than the AFR for a particular month, the test rate for that month is the lower of the two such rates.

Special rule for certain transactions before July 1, 1985.—For sales or exchanges after December 31, 1984, and before July 1, 1985, or property other than new property eligible for the investment credit, the test rate for "borrowed amounts" not exceeding $2 million exceeding $2 million is 9 percent. The test rate for borrowed amounts exceeding $2 million is a "blend" of 9 percent in the first $2 million and 110 percent of the AFR on the excess. In applying the $2 million limitation, all sales or exchanges that are part of the same transaction (or a series of related transactions) are treated as one transaction, and all debt instruments arising from the same transaction (or a series of related transactions) are treated as one debt instrument. The imputation rate for transactions during this same period is 10 percent for borrowed amounts up to $2 million and a blend of 10 percent and 120 percent of the AFR for borrowed amounts exceeding $2 million.

Limitation on principal amount of a debt instrument

Notwithstanding the computation of "issue price" discussed above (and, accordingly, the buyer's basis in the property), the principal amount of any debt instrument under section 1274 in a "potentially abusive situation" is equal to the fair market value of the property sold.[9] This limitation applies whether the slated interest is adequate or inadequate under section 1274.

A potentially abusive situation includes any transaction involving a "tax shelter" (as defined in sec. 6661(b)(2)(C)(ii)). It also includes any other situation that, because of (1) recent sales transactions, (2) nonrecourse financing, (3) financing with a term beyond the economic life of the property, or (4) other circumstances, is of a type which the Treasury Department by regulation identifies as having a potential for abuse.

[8] *Exceptions*

Specific exceptions are provided for certain debt instruments that otherwise would be subject to section 1274. However, these debt instruments may be subject to the rules of section 483. As discussed below, section 483 tests the adequacy of interest in a debt instrument without requiring annual inclusion and deduction of accrued but unpaid interest. Debt instruments that are excepted from section 1274 are as follows:

Personal-use property.—Issuers (but not holders) of debt instruments issued in exchange for property, substantially all of which will not be used by the issuer in a trade or business or held by the issuer for the production or collection of income, are excepted from section 1274. Accordingly, a cash-method issuer of such an obligation may claim interest deductions only for amounts of stated interest actually paid during the taxable year.

Annuities.—Section 1274 does not apply to an annuity to which section 72 applies and the liability for which depends in whole or in substantial part on the life expectancy of any individual. In addition, section 1274 does not apply to any annuity (whether or not dependent upon life expectancy) issued by an insurance company (subject to tax under Subchapter L), provided the annuity is issued (1) in a transaction in which only cash or another annuity contract meeting the requirements of this exception is exchanged for the annuity, (2) upon exercise of an election under a life insurance policy by a beneficiary thereof, or (3) in a transaction involving a qualified pension or employee benefit plan.

Patents.—An exception is provided for payments attributable to a transfer of a patent, provided the transfer is eligible for capital gain treatment under section 1235 and such payments are contingent upon the productivity, use, or disposition of the patent. Thus, the exception does not apply in the case of a deferred lump-sum amount payable for a patent.

Farms.—Section 1274 does not apply to debt instruments received by an individual, estate, or testamentary trust, by a small business corporation (as defined in sec. 1244(c)(3)), or by certain partnerships[10] in exchange for a farm. This exception applies only if the sales price does not exceed $1 million.[11]

[7]Appropriate adjustments to the rates are to be made for application to debt instruments, the interest on which is wholly or partly exempt from tax (sec. 1288).

[8]The mechanism provided by the temporary regulations is intended to respond to a problem that may exist where interest rates decline after the period in which the Federal rates were determined.

[9]The principal amount of the note is reduced to reflect the fair market value of other consideration involved in the transaction. This provision prevents both overstatement and understatement of the buyer's basis in the property. The purpose of the latter restriction is to prevent the intentional overstatement of OID. A taxpayer might be motivated to overstate the interest element of a sale, for example, if the property involved in the sale were nondepreciable or the seller were not subject to U.S. tax on interest income.

[10]That is, those partnerships whose capital is not in excess of the limits specified in sec. 1244(c)(3).

[11]Sales and exchanges that are part of the same transaction or a series of related transactions are treated as one sale or exchange, in order to prevent taxpayers from avoiding the $1 million limitation by divjding what is in substance a single transaction into two or more smaller transactions.

Principal residences.—Debt instruments received by an individual as consideration for the sale or exchange of that individual's principal residence (within the meaning of sec. 1034) are not subject so section 1274, regardless of the amount involved in the transaction.

Total payments not exceeding $250,000.—Section 1274 does not apply to any debt instrument given in exchange for property if the sum of (1) the payments due under the instrument (whether designated principal or interest) and under any other debt instrument [9] given in the transaction, and (2) the fair market value of any other consideration given in the transaction, does not exceed $250,000.[12]

Land transfers between related persons.—Section 1274 does not apply to an instrument to the extent that section 483(f), relating to certain sales of land between related parties, applies.

C. Measurement of Principal and Interest in Transactions Not Subject to the OID Rules: Section 483

In general

Section 483 generally applies to nonpublicly traded debt instruments given in exchange for nonpublicly traded property where such debt instruments are not subject to section 1274. Under section 483, an instrument is tested for adequate stated interest in the same manner, and using the same test rates, as under section 1274. Where stated interest is inadequate, section 483 recharacterizes a portion of the principal amount of the instrument as interest which, in general, is equal to the additional amount of OID that section 1274 would inpute.[13]

However, unlike section 1274, section 483 does not require imputed interest (or stated interest) to be accounted for on an accrual basis. Stated interest on a debt instrument subject to section 483 is accounted for under the taxpayers's usual method of accounting. Imputed interest is accounted for by cash-method taxpayers when the payments, portions of which are recharacterized as interest by section 483 are made, or by accrual-method taxpayers when such payments are due. The portion of the imputed interest that is allocated to a payment is that portion of the total imputed interest which, in a manner consistent with the method of computing interest under the OID rules, is properly allocable to such payment.

Exceptions

Excepted transactions.—Section 483 contains the same exceptions for sales of personal-use property, annuities, and patents that apply to section 1274. In addition, section 483 does not apply where the sales price of the property does not exceed $3,000.

Lowest test rates.—In the case of a sale after June 30, 1985, of a principal residence where the purchase price does not exceed $250,000 or of farm land where the price does not exceed $1 million (where such sale would qualify for exception from section 1274), the test rate may not exceed 9 percent, and imputation rate may not exceed 10 percent. If the purchase price of a principal residence exceeds $250,000, these limits apply to the portion of the deferred payments that $250,000 bears to the sales price; the rates based on the AFR apply to the remainder. In addition, for sales or exchanges of land between an individual and that individual's brothers, sisters, spouse, ancestors or lineal descendants, the test rate under section 483 may not exceed 6 percent. This preferential rate applies only to the extent that the sales price of the land, and the [10] sales price of all prior sales of land between the same individuals in a calendar year, does not exceed $500,000.

D. Regulatory Authority Relating to Debt-For-Property Transactions

The Treasury Department has authority to issue regulations dealing with the treatment of transactions involving varying interest rates, put or call options, indefinite maturities, contingent payments, assumptions of debt instruments not specifically dealt with in the statute, and other circumstances. The regulatory authority granted to the Treasury Department contemplates possible modification of the generally applicable rules where appropriate to carry out the purposes of the state, including the provisions of exceptions for transactions not likely to significantly reduce the tax liability of the purchaser by reason of overstatement of the basis of the acquired property.

Pursuant to its regulatory authority, the Treasury Department has provided the monthly rates in order to address the problems that may arise where the statutorily determined rates are significantly higher than prevailing market interest rates.

E. Assumptions of Debt in Connection With the Sale of Property

Neither section 483 nor section 1274 applies to the following debt obligations assumed in connection with the sale or exchange of property, or to debt obligations which property is taken subject to, provided that the terms and conditions of the obligation are not modified in connection with the sale.

Pre-October 16, 1984 obligations

Loans made on or before October 15, 1984, and assumed after December 31, 1984, in connection with a sale or exchange of property, are not subject to section 483 or section 1274 by reason of such assumption.[14] This exception does not apply, however, if the purchase price of the property exceeds $100 million.

Residences

Loans assumed in connection with a sale of a residence by an individual, estate, or testamentary trust are exempt from sections 483 and 1274 if either (1) at the time of the sale, the property was the seller's (or if applicable, the decedent's) principal residence (within the meaning of sec. 1034) or (2) during the two-year period prior to the sale, no substantial portion of the property was of a character subject to an allowance for depreciation. Thus, an assumption of a loan in connection with the sale of

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The exception for farms as well as the exceptions following are nevertheless subject to sec. 483, as more fully discussed in the text below.

[12]This exception is subject to an aggregation rule similar to that provided under the farm sale exception.

[13]For certain transactions, lower test and imputation rates are provided. These transactions are described in the text below.

[14]The exceptions relating to assumptions of loans also apply to loans which property may be taken subject to.

a principal residence, or of a vacation home on which a taxpayer may not claim depreciation (e.g., by reason of sec. 280A), generally is not subject to testing for unstated interest under sections 483 or 1274. This exception does not apply, however, to a sale of property that was at any time held by the seller for sale to customers in the ordinary course of business.

[11] *Farms*

Neither sections 483 or 1274 apply to loans assumed in connection with a sale by a "qualified person" of real property used as a farm (within the meaning of sec. 6420(c)(2)) at all times during the three-year period prior to the sale. The exception also applies to loans assumed in connection with the sale of tangible personal property used by the seller of such a farm in the active conduct of a farming business that is also sold in connection with the sale of such a farm for use by the buyer in the active conduct of a farming business. The term "qualified person" includes an individual, estate, or testamentary trust, or a corporation or partnership having 35 or fewer shareholders or partners immediately prior to the sale or exchange, owning at least a 10-percent interest in the property sold.

Trades or businesses

Loans assumed in connection with a sale by a "qualified person" of a trade or business are exempt from sections 483 and 1274. Trade or business has the same meaning as under section 355, except that the rental of real estate under no circumstances qualifies as an active business for this purpose. For purposes of this exception, the term "qualified person" has the same meaning as in the exception for assumptions in connection with the sale of farm properties except that the sale must constitute a disposition of the seller's entire interest in the trade or business and in all substantially similar trades or businesses.

An exception is also provided for a sale of real property used in an active trade or business (as defined above) by someone who would be a qualified person but for the fact that his entire interest in the trade or business is not being sold. Thus, for example, loans assumed in connection with a casual sale by a sole proprietor of real property used in his business could be exempt from sections 1274 nd 483.

The trade or business property exception does not apply to a sale of property qualifying under the farm exception, or to property that is new property eligible for the investment credit in the buyer's hands.

F. Below-Market Loans

Section 7872 of the Code, added by the 1984 Act, generally provides that certain loans bearing interest at a below-market rate, are to be treated as loans bearing interest at the market rate accompanied by a payment or payments from the lender to the borrower which are characterized in accordance with the substance of the particular transaction (e.g., gift, compensation, dividend, etc.). The market rate of interest for purposes of section 7872 is assumed to be 100 percent of the AFR at the time the loan is made in the case of a term loan, or in the case of a demand loan, 100 percent of the AFR in effect over the time that the loan is outstanding.

Section 7872 applies to (1) loans where the foregone (i.e., below-market) interest is in the nature of a gift, (2) loans to an employee from a employer or to an independent contractor or one for whom the independent contractor provides services, (3) loans between a [12] corporation and a shareholder of the corporation, (4) loans of which one of the principal purposes of the interest arrangement is the avoidance of any Federal tax, and (5) to the extent provided in regulations, any below-market loan if the interest arrangement of such loan has a significant effect on any Federal liability of either the lender or borrower. Below-market loans made by individuals pursuant to arrangements providing for the satisfaction of personal needs in retirement may be considered to come within either of the last two categories. The application of section 7872 is limited by certain *de minimis* exceptions and, for certain gift loans, by the net investment income of the borrower.

G. Cost Recovery Deductions For Real Property

In general, domestic real property placed in service after March 15, 1984, and qualifying as recovery property, may be depreciated on an accelerated basis under ACRS over an 18-year period, under tables of recovery percentages prescribed by the Treasury Department. These tables reflect a "mid-month" convention for property placed in service after June 22, 1984. Taxpayers may also elect to depreciate such property on a straight-line basis over 18, 35, or 45 years. The recovery period under ACRS for low-income housing described in sections 1250(a)(1)(B)(i), (ii), (iii) or (iv) is 15 years and no mid-month convention is used.

Under transitional rules provided by the 1984 Act, property placed in service after March 15, 1984, pursuant to binding contracts entered into, or where construction was commenced by or for the taxpayer, prior to March 16, 1984, may be eligible for a 15-year recovery period. Special rules under the 1984 Act are also provided relating to components of real property placed in service prior to March 16, 1984, that are placed in service on or after the date.[15]

[13] III. REASONS FOR CHANGE

A. The Imputed Interest Rules

In general

The imputed interest rules of the 1984 Act have been perceived as complex in several respects. The changes made by the Committee bill attempt to simplify the imputed interest rules, while retaining the basic purposes of the 1984 legislation.

The imputed interest rate

The Committee believes that taxpayers entering into smaller transactions should not have to keep track of the fluctuating imputed interest rates prescribed by the 1984 Act. Accordingly, the Committee bill provides a single maximum test rate of 9 percent for transactions where the amount of seller financing does not exceed $2 million. In addition, in order not to create unfairness where the size of the transaction is slightly above the $2 million threshold amount, the Committee bill phases out the 9-percent rate on a dollar-for-dollar basis on amounts between $2 million and $4 million.

[15] Sec. 168(f)(1).

The definition of the AFR provided by the 1984 Act was intended to be a current measure of minimum borrowing rates for a given range of maturities. The mechanism for determining the AFR under the 1984 Act (and the temporary Treasury regulations), however, lags somewhat behind the market. For example, where interest rates are falling rapidly, it is possible for the appropriate borrowing rates for a particular transaction to be slightly lower than 110 percent of the AFR. Accordingly, the Committee believes that it is appropriate to reduce the imputed interest rate to 100 percent of the AFR.

The Committee believes that an imputed interest rate of 100 percent of the AFR (for transactions not eligible for the lower fixed test rate) is a fair minimum rate and one which will not impose hardships on taxpayers. In recognition that there might be certain isolated circumstances in which a different rate would be more appropriate, the Committee bill grants the Treasury Department authority to issue regulations that would permit taxpayers to demonstrate that a lower rate is more accurate in proper cases.

The Committee is concerned, however, that even with the lower test rate provided by the bill, sales of property may be hindered when interest rates in the financial markets (and hence the Federal rates) increase above interest rates that were typically experienced. Accordingly, the Committee amendment provides that if the AFR exceeds 12 percent, the discount rate used in determining the adequacy of interest in a transaction will be limited in certain cases.

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[14] The Committee also believes that it is an unnecessary complication to maintain the dual mechanism for determining the AFR that is currently provided by the 1984 Act and temporary Treasury regulations. The mechanism provided by the regulations has worked adequately to provide a rate which is current, yet because of the three-month period that a taxpayer may use the rate, is stable. Consequently, the Committee bill eliminates the six-month rate.

Finally, the Committee believes that the higher imputation provided by the 1984 Act often acted as a penalty for uninformed taxpayers. Knowledgeable taxpayers will always avoid the higher imputation providing for stated interest at the applicable test rate. Accordingly, the Committee bill eliminates the higher imputation rate.

Method of accounting

The 1984 Act attempted to prevent mismatching of interest income and interest deductions by requiring both the buyer and the seller to account for the interest in the transaction on the accrual method of accounting. Nevertheless, calculating and accounting for accrued but unpaid interest may impose hardship on taxpayers who might have to report taxable income in advance of receiving cash with which to pay the tax. This aspect is inconsistent with the Committee's intention to relieve smaller transactions from complexity. Therefore, the Committee bill permits taxpayers in certain smaller transactions to elect to use the cash receipts and disbursements method of accounting for interest income and expense, provided that both buyer and seller jointly agree to do so.

Assumptions

While the changes that the 1984 Act made in the imputed interest rules were in large part intended to stop abuses that result from the manipulation of principal and interest in a debt instrument arising from a seller-financed sale of property, many taxpayers have argued that the assumption of a debt instrument does not present the same potential for abuse as does a seller-financed debt instrument because where a debt instrument is assumed and its terms are not modified in connection with the transaction, there is no opportunity for the parties to manipulate principal and interest on the loan. Accordingly, under the Committee bill, the imputed interest rules generally will not apply to assumptions of loans.

B. Below-Market Loans

The Committee believes that encouraging individuals to provide in advance for the potential need for increasing levels of personal care, including long-term nursing care, in the advanced stages of retirement may further a valuable social objective. The committee also believes that it is desirable for individuals to be able to do so in arrangements in which substantial initial payments are refundable, hence providing the individual with greater flexibility than where the payment is not refundable. Accordingly, the Committee bill clarifies the application of the below-market loan rules with respect to certain arrangements under which such potential needs [15] may be provided for. Under the committee bill, certain loans to "continuing care facilities" pursuant to "continuing care contracts" are excepted from the below-Market loan provisions. Loans to continuing care facilities pursuant to continuing care contracts are, however, subject to the below-market loan rules to the extent that specific criteria for the exception are not met.

In light of the changes made by the Committee bill to the computation of the applicable Federal rate, the Committee believes that the appropriate time for determining the adequacy of interest on employer-employee loans where the employee uses the proceeds toward the purchase of a principal residence in connection with certain changes in employment is the time the employee contracts to purchase the principal residence rather than at the time the loan is made. Accordingly, the Committee bill amends the below-market loan rules to so provide.

C. ACRS Recovery Period for Real Property

The Committee believes that, in light of the current budget deficit of the Federal Government, there should be an offset for the revenue loss resulting from the changes the Committee bill makes to the imputed interest rules (much of which results from transactions involving real property.) The Committee also believes that the useful life of most real property exceeds 18 years and that an increase in the cost recovery period for real property would more correctly measure the income from real property. Accordingly, to

maintain revenue neutrality, the Committee bill would extend the ACRS recovery period of real property (other than low-income housing) from 18 years to 19 years.

[16] IV. EXPLANATION OF THE BILL

A. The Imputed Interest Rules

1. The Imputed interest rate

In general

The Committee bill makes five basic changes to the imputed interest rates. First, the Committee bill reduces the test rate from 110 percent of the AFR to 100 percent of the AFR. Second, the Committee bill provides for lower imputed interest rates for certain smaller transactions. Third, the Committee bill provides lower imputed interest rates for certain transactions where the AFR exceeds 12 percent. Fourth, the Committee bill provides that the imputation rate would be the same as the test rate (i.e., there would be no higher "penalty rate" where inadequate interest is stated). Finally, the Committee bill revises the computation of the AFR from a semiannual rate to a monthly rate.

Lower overall imputed interest rate

Under the Committee bill, the imputed interest rate (i.e., the test rate and the imputation rate) is reduced to 100 percent of the AFR.

Lower imputed interest rates for certain smaller transactions

The Committee bill places a limit on the imputed interest rates in smaller transactions which do not involve new property eligible for the investment tax credit. Under these rules, where the amount of seller financing[16] does not exceed $2 million, the Committee bill provides that the imputed interest rate cannot exceed 9 percent.[17] Where the amount of seller financing exceeds $2 million but is less than $4 million, the imputed interest rate is a "blend" of 9 percent on a specified portion of the seller financing and the 100 percent of the AFR on the remainder.[18] The portion of the seller-financing eligible for the 9 percent rate is equal to $2 million reduced dollar-for-dollar by the amount of seller financing over $2 million. For example, if the amount of seller financing were $2.5 million, the imputed interest rate would be the weighted average of 9 percent on $1.5 million (i.e., $2 million reduced by the excess of $2.5 million over $2 million) and the AFR on the remaining $1 million.[19] Where the amount of seller financing is $4 million or more, the imputed interest rate is equal to 100 percent of the AFR, unless the [17] special limitation described in the following section applies. The $2 million and $4 million "thresholds" will be indexed for inflation beginning after 1988.

For sales of new property eligible for the investment credit, the imputed interest rate for a seller-financed debt instrument is equal to the AFR regardless of the amount of seller financing, unless the special limitation discussed below applies.

Limitation on discount rate in certain circumstances where AFR exceeds 12 percent

Under the Committee bill, for a three-year period, the imputed interest rate in transactions involving $4 million or more in seller financing is limited in certain circumstances, and the imputed interest rate for transactions involving between $2 million and and $4 million is further limited.

If the transaction involves $4 million or more in seller financing and the AFR exceeds 12 percent and one of two tests is met, the imputed interest rate is limited to 12 percent plus one-third of the excess of the applicable Federal rate over 12 percent.

The first test is satisfied if the debt instrument is issued in exchange for property which is depreciable or amortizable in the hands of the buyer and (a) the stated principal amount of the debt instrument is not more than 50 percent of the total sales price of the property, (b) the term of the instrument (including any extension or renewal) is not greater than two-thirds of the "statutory recovery period"[20] of the property, and (c) the instrument requires the unconditional payment at fixed periodic intervals of one year or less of at least 80 percent of the total interest allocable to the period to which the payment relates.

The second test is satisfied if the debt instrument is given in exchange for property that is nondepreciable and nonamortizable in the hands of the purchaser. Except as provided in Treasury regulations, a purchase of a partnership interest or stock representing control[21] of a corporation will not qualify under this test. Such purchases will be treated as purchases of the underlying assets and the debt instruments will be eligible for the limited rate only if they satisfy the conditions of the first test.

The Committee expects that the regulations will permit a transaction to qualify for the limited rate under the second test if the transaction does not result in the purchaser's obtaining a stepped-up basis in all or a portion of the assets of the corporation or partnership. For example, the second test generally should be satisfied and the rate limitation therefore should apply, without regard to whether the first test would be satisfied if the debt instrument were issued for the underlying assets, if the transaction involves a qualified stock purchase under section 338 and no election is made or deemed to have been made under that section. Likewise, the limitation should generally apply if the purchaser will not obtain a stepped-up basis in the underlying assets by virtue of a corporate [18] liquidation under section 331 or, in the case of the acquisition of a partnership interest, by reason of an election under section 754 or a liquidation of the partnership under section 732(b).

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[16]The amount of seller financing is measured by the stated principal amount of the seller-financed debt instrument.

[17]As under present law, all rates will be compounded semiannually.

[18]A special limitation on the AFR used in the blending formula may apply where the AFR exceeds 12 percent. See discussion below.

[19]The weighted average in the example may be computed as follows, assuming an AFR of 11.5 percent; 9 percent times 0.6 (i.e., $1.5 million divided by $2.5 million) plus 11.5 percent times 0.4 (i.e., $1.0 million divided by $2.5 million) equals 10 percent.

[20]For purposes of this provision, the term "statutory recovery period" means the recovery period under section 168 in the case of property with respect to which deductions are allowable under that section, and in the case of other property, the period over which deductions for depreciation or amortization are otherwise allowable.

[21]For his purpose, control has the same meaning as under sec. 304(c).

If a debt instrument is issued in exchange for several properties, the principal amount must be allocated to each of the properties on the basis of their relative fair market values, and the three-part test will be applied separately to each depreciable or amortizable piece of property. If the transaction involves a sale of land and any 15-year, 18-year or 19-year real property (together with a *de minimis* amount of incidental personal property), no allocation must be made, and both the land and the incidental personal property shall be treated as having a statutory recovery period equal to the statutory recovery period for the depreciable real property.

In the case of transaction involving seller financing of more than $2 million but less than $4 million, the bill provides that, subject to the two tests described above, the imputed interest rate is determined by blending 9 percent with the discount rate determined pursuant to the limitation just described.

The limitation applies only to sales or exchanges occurring on or before June 30, 1988.

Elimination of the penalty rate

Under the Committee bill, the imputation rate for a debt instrument that fails to state adequate interest will be the same as the test rate for that instrument. Accordingly, there is only one "imputed interest rate" for a transaction and there is no separate "penalty rate" where a debt instrument does not state adequate interest for any reason.

Determination of the applicable Federal rate

Under the Committee bill, the sole mechanism for determining the AFR will be the one currently prescribed by the temporary Treasury regulations. The alternative mechanism under present law for determining the six-month rate prescribed by the 1984 Act will be eliminated.

Under these revised rules, the AFR will be computed using the same methodology as under present law, except that the rates will be determined on a monthly basis and the rate will reflect the average yields for one-month periods. In addition, the AFR for a particular month may be used as the imputed interest rate for contracts for sales or exchanges entered into in that month and the next two succeeding months.

Regulatory authority

Aggregation rules.—The Committee bill authorizes the Treasury Department to issue regulations specifying the circumstances in which transactions will be treated as "part of the same transaction or related transactions" for the purpose of applying the $2 million and $4 million limitations. These regulations will address transactions involving multiple sellers, multiple buyers, "pass-through" entities, and one transaction structured as a series of small transactions. It is anticipated that the regulations will aggregate transactions in which multiple buyers or multiple sellers are acting in concert. The Committee does not intend, however, that multiple [19] sales by a taxpayer who is a dealer in the property sold, to unrelated buyers in otherwise unrelated transactions (such as typically occurs when a home builder sells homes in unrelated transactions to different home buyers), be aggregated.

Lower rates.—The Committee bill also provides that the Treasury Department is authorized to issue regulations under which taxpayers would be permitted to demonstrate that, in appropriate circumstances, a rate lower than the AFR provided by the statute, but calculated according to the same principles as the AFR, is a more appropriate imputed interest rate for a particular debt instrument. For example, it may be appropriate to use a lower rate where the borrower can demonstrate that it can borrow in the open market at a rate less than the AFR applicable to that maturity of the debt instrument for which the imputed interest rate is to be applied. The regulatory authority granted by this provision is effective as if included in the imputed interest provisions of the 1984 Act.

Coordination with other Code provisions.—The Treasury Department is authorized to issue regulations regarding the relationship of the imputed interest provisions to other Code provisions. The Committee intends to limit the benefit of the lower test rate (provided by section 1274A) to bona fide sales of property between unrelated parties. Accordingly, the regulations may provide that section 1274A would not apply to certain transactions undertaken to avoid other provisions of the Code that require an arm's-length interest rate. For example, where a corporation purchases $2 million of nonpublicly traded debt yielding a rate equal to the AFR and sells that debt obligation to its shareholders for a note paying interest at 9 percent, the Committee understands that the regulations would provide that there would be additional interest income to the corporation. The Committee anticipates that the Treasury Department will exercise the regulatory authority granted by the 1984 Act to provide rules under which contingent payments (e.g., payments based on future sales or rental receipts) may be taken into account in determining whether or not a debt instrument has adequate stated interest in transactions that would not thereby be subject to abuses. In addition, the Committee intends that the Treasury Department's 1984 Act regulatory authority will be exercised with regard to situations where the OID rules are avoided as a result of prearranged or systematic discounting of seller-financed debt instruments.

2. Method of accounting

The "cash-cash" election

The Committee bill provides that, in the case of certain debt instruments that otherwise would be subject to section 1274, interest income and expense arising from such debt instruments may be accounted for on the cash receipts and disbursements method of accounting. To be eligible for such treatment, (1) the stated principal amount of the debt instrument cannot exceed $2 million, (2) the debt instrument must arise from the sale of property by a cash-basis taxpayer who is not a dealer in the type of property sold, and (3) the lender and the borrower must jointly elect such treat-[20] ment.[22] A debt instrument meeting these requirements is to be known as a "cash-method debt instrument."

Transfers and assumptions of cash-method debt instruments

Special rules are provided relating to

[22]The Committee intends that, until regulations are issued specifying a different method of election, the parties can make the election by so indicating in their respective tax returns and stating the election clearly in the debt instrument.

the treatment of taxpayers who are the successors to either the issuer or holder of a cash-method debt instrument. Generally, such a successor shall also be required to use the cash receipts and disbursements method of accounting for interest income and expense arising from the cash-method debt instrument. Accordingly, where an accrual-method taxpayer assumes the liability on a cash-method debt instrument, that taxpayer must use the cash-method to account for interest expense arising from the instrument. An exception is provided where a cash-method debt instrument is transferred to a subsequent holder who uses the accrural method of accounting. In this case, the exception requires the subsequent holder to continue to use his normal method of accounting (i.e., to use the accrual method).

Regulatory authority

The Treasury Department is authorized to issue regulations prescribing rules to prevent abuses of the special treatment afforded to cash-method debt instruments. The Committee intends that the delegation of regulatory authority will be exercised only to prevent abuse situations.

One situation that such regulations may address is the timing of deductions for interest on indebtedness incurred or continued to acquire or carry a cash-method debt instrument. Another situation that may be addressed is one where a cash-method debt instrument remains outstanding when the property, the initial sale of which gave rise to the cash-method debt instrument, is resold in a transaction involving a seller-financed debt instrument.

A third situation which the regulations may address relates to the treatment of transfers of cash-method debt instruments. It is anticipated that these regulations will clarify existing law regarding (1) the amount and character of gain realized on disposition of a cash-method debt instrument, (2) the allocation of payments on the debt instrument between income and recovery of basis for a subsequent holder, and (3) the timing of interest deductions for, and the allocation of interest deductions between, the initial issuer and a taxpayer who assumes the issuer's obligations on a cash-method debt instrument.[3]

3. Assumptions

Under the Committee bill, if an existing debt instrument is assumed in connection with the sale or exchange of property (or if the property is acquired subject to an existing debt instrument), section 1274 and section 483 do not apply to such existing debt instrument by reason of such assumption (or acquisition) unless the terms of the existing debt instrument are modified in connection [21] with the transaction or the nature of the transaction is changed.[24] If only minor modifications are made in the terms of the loan, the Committee does not intend that the imputed interest rules will be applied.

Under temporary Treasury regulations, for installment reporting purposes, a so-called wrap-around debt instrument may be treated like an assumption of the so-called "wrapped" (or underlying debt). However, many taxpayers have taken the contrary position. The Committee believes that a wrap-around debt should be treated consistently for purposes of the installment reporting and imputed interest rules. The Committee does not wish to address the proper treatment of wrap-around debt for installment reporting at this time. Moreover, the Committee wishes to avoid the situation where the seller takes the position that the wrap-around debt does not result in immediate taxation, while the buyer takes the position that the entire amount of the wrap-around debt is exempt from the imputed interest rules. Accordingly, until and unless it is ultimately settled that a wrap-around debt instrument is treated as an assumption for installment reporting purposes, the Committee intends that the exception in the Committee bill relating to assumptions should not apply to wrap-around debt instruments.

B. Below-Market Loan Provisions

1. Loans to continuing care facilities

In general

Under the Committee bill, certain below-market loans to a "continuing care facility," made pursuant to a "continuing care contract" are excepted from the below-market loan provisions of the Code, i.e., no additional interest and offsetting payment will be attributed to such loans. Loans to continuing care facilities pursuant to continuing care contracts are subject to he below-market loan provisions to the extent that the criteria for the exception are not met.

Continuing care contract

A continuing care contract is an arrangement between an individual or a married couple and a continuing care facility with certain specified requirements. Under the first requirement, a retired individual or couple must be entitled to use of the continuing care facility for the remainder of the individual's or both married spouses' lives. Under the second requirement, such use must commence with residence in a separate, independent living unit provided by the continuing care facility.[25] The independent living unit is provided for so long as the individual or either of the married spouses is capable of living independently, and during this period the individual may not require (in order to maintain residence in [22] such independent living unit) care other than the providing of meals and other personal care services, as described below.

Under the third requirement, during the period in which the individuals reside in the independent living units, the continuing care facility must be obliged to provide such individuals with various "personal care" services. These are services that are designed to prolong an elderly person's ability to maintain an independent residence. Examples are services relating to maintenance of the residential unit, the preparation of meals, (either on a common basis or within the separate living unit), and daily aid and supervision relating to

[23] *See, e.g., United States* v. *Midland-Ross Corp.*, 381 U.S. 54 (1965); Treas. Reg. sec. 1.61-7; Code secs. 1276 *et. seq.*

[24] The Committee intends that the nature of the transaction is to be considered changed if, for example, the loan which is to be assumed arose in a transaction that was excepted from section 483, but the subsequent transaction does not qualify for the exception. *See, e.g.*, Treas. Reg. sec. 1.483-1(f)(6)(iv) (Example 4).

[25] It is contemplated that such units would have their own kitchen, bath, and living area, and would be of a nature that provides the same degree of convenience and privacy as a private residence.

routine medical needs.

Under the fourth requirement, the continuing care facility must also undertake to provide long-term nursing care for those individuals who are no longer capable of living independently, even with the aid of personal care services. Under the fifth requirement, the continuing care contract must require the continuing care facility to provide the personal care and long-term nursing services without substantial additional cost to the individual, i.e., there must be a significant insurance-like element for the individual.

The Committee intends that the personal care and custodial care services are to be substantial, so that they in fact prolong the ability of an individual to maintain an independent residence, except in the case of sudden, totally disabling medical cause. For example, the mere provision of maid services and a registered nurse on the premises of a retirement community would not be sufficient.

Continuing care facility

A continuing care facility is one or more facilities which are designed to provide services under continuing care contracts and substantially all of the residents of which have entered into continuing care contracts. The term "substantially all" is intended to permit isolated situations where an individual may enter the continuing care facility in immediate need of long-term nursing care, particularly if in conjunction with a spouse who simultaneously enters a separate independent living unit in the continuing care facility, or where a newly opened facility may accept several individuals directly into the long-term nursing facility (under normal nursing care arrangements, i.e., not pursuant to continuing care contracts) in order to fill excess capacity.

In addition, substantially all of the facilities used to provide the services that must be provided under a continuing care contract must be in facilities that are either owned or operated by the continuing care facility.

The Committee believes that the exception from the below-market loan rules should be limited to facilities that provide personal care services designed to prolong the ability of retired persons to live independently, as well as an insurance-like arrangement providing for the possible need for long-term nursing care. Accordingly, the exception from the below-market loan rules does not apply to below-market loans to facilities where an individual would generally receive long-term nursing care immediately upon entering the facility without any period of living independently, i.e., facilities of a type traditionally considered to be nursing homes.

[23] *Limitations*

The exception is available for a loan only as of the calendar year in which the lender has attained age 65. A loan from either or both members of a married couple where only one spouse has attained age 65, will be treated as qualifying for the exception where both of the spouses are to reside in the continuing care facility. Loans made by an individual prior to reaching age 65 which do not qualify initially may nevertheless qualify as of the calendar year in which the individual reaches age 65. The Committee believes that the benefit of this exception should not be afforded to the provision of luxurious accommodations. Accordingly, the exception applies only to the extent that the principal amount of a loan, when added to the aggregate outstanding amount of all other previous loans between the lender (or if the lender is married, the lender and the lender's spouse), to any continuing care facility, does not exceed $90,000. This amount is indexed for inflation.

Transactions not treated as loans

The Committee understands that the below-market loan provisions of the Code prescribe the treatment only of transactions that are loans for Federal income tax purposes,and that such provisions do not define and did not alter prior law relating to what transactions are or are not to be treated as loans. The Committee understands that entrants into a life care facility generally expect to reside at the facility for a considerable length of time. The Committee also understands that a payment to a continuing care facility pursuant to a continuing care contract frequently is wholly or partially refundable for a relatively brief period (e.g., six months) essentially for consumer protection purposes pursuant to State law or regulations. The Committee also understands that payments to a continuing care facility are often refundable on a declining pro rata basis over a somewhat longer period (often up to eight years). The Committee understands that such payments ordinarily would be treated as the advance payment of fees and not as loans under present law.

2. Employee relocation loans

The Committee bill modifies the below-market loan rules with respect to so-called "employee relocation loans." An employee relocation loan is a loan from an employer to an employee, the proceeds of which are used by the employee toward the purchase of a principal residence in connection with commencement of work by the employee at a new principal place of work. The purchase of the principal residence must occur in a situation where any moving expenses incurred by the employee would be deductible under section 217 of the Code.

In the case of such employee relocation loans, the rate used for determining whether the loan is a below-market loan to which additional interest will be imputed, is the AFR for the month in which the employee enters into a written contract for the purchase of the principal residence rather than the month in which the loan is made.

[24] C. Accelerated Cost Recovery System

Under the Committee bill, the minimum recovery period for domestic real property qualifying as recovery property generally is increased from 18 years to 19 years. However, this change in the recovery period does not affect the ACRS provisions relating to low-income housing (which remains at 15 years).

D. Effective Dates

Imputed interest rules

The provisions of the Committee bill relating to the amendment imputed interest rules are effective for sales or exchanges occurring after June 30, 1985. However, the provision limiting the imputed interest rate where the AFR exceeds 12 percent does not apply to any sale or exchange after June 30, 1988. The Committee understands that where a sale or exchange takes place after June 30, 1985, pursuant to a bind-

ing contract entered into on or before that date, the imputed interest rates for such a transaction are to be determined pursuant to the provisions of the Committee bill using the applicable Federal rates in effect on the date the binding contract was entered into.

The regulatory authority under which the Treasury Department may permit a taxpayer to use a lower imputed interest rate is effective as if included in the imputed interest provisions of the 1984 Act.

Below-market loans

The provisions of the Committee bill relating to below-market loans to continuing care facilities pursuant to continuing care contracts are generally effective with respect to such loans that are made after the date of enactment. All such loans made on or before the date of enactment are excepted from the below-market loan rules.

The provisions of the Committee bill relating to employee relocation loans are effective for loans made pursuant to purchase contracts entered into after June 30, 1985.

ACRS recovery period for real property

The provision of the Committee bill relating to the ACRS recovery period for real property is generally effective for property placed in service after May 8, 1985. Transitional rules similar to those under the 1984 Act are provided for property that is placed in service after May 8, 1985, and before January 1, 1987, where there was a binding contract to construct or acquire the property, or where construction was begun by or for the taxpayers before May 9, 1985. Special rules apply to cost placed in service after May 8, 1985.[26]

In addition, a conforming amendment relating to the eligibility of lessee-incurred costs for the rehabilitation tax credit (secs. 46 and 48(g)) is effective for leases executed prior to May 22, 1985, if the lessee signed the lease before May 17, 1985.

* * * * *

Conference Report 99-250
1st Session
[Bracketed numerals indicate official report page numbers]

[26]Sec. 168(f)(1).

SIMPLIFICATION OF IMPUTED INTEREST RULES

August 1, 1985.—
Ordered to be printed

Mr. Rostenkowski, from the committee of conference, submitted the following conference report to accompany H.R. 2475[1]

* * * * *

[12] JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 2475) to amend the Internal Revenue Code of 1954 to simplify the imputed interest rules of sections 1274 and 483, and for other purposes, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

The Senate amendment struck out all of the House bill after the enacting clause and inserted a substitute text.

The House recedes from its disagreement to the amendment of the Senate with an amendment which is a substitute for the House bill and the Senate amendment. The differences between the House bill, the Senate amendment, and the substitute agreed to in conference are noted below, except for clerical corrections, conforming changes made necessary by agreements reached by the conferees, and minor drafting and clarifying changes.

I. SIMPLIFICATION Of GENERAL IMPUTED INTEREST RULES

A. The Imputed Interest Rules

Present law

The imputed interest rate

Overview

Under the imputed interest rules, whether there is adequate stated interest in a debt instrument issued for nonpublicly-traded property is determined by reference to an appropriate "test rate." Where adequate interest is not stated, the imputed interest rules recharacterize a portion of the principal amount of the debt instrument for income tax purposes using a somewhat higher "imputation rate." The amounts of principal and interest as recharacterized will generally determine the seller's "amount realized," the buyer's basis in the property, and the amount of interest deductions and interest income for the buyer and the seller, respectively. The test rate for a debt instrument subject to the imputed interest rules is the rate in effect on the first day there is a binding contract for the sale or exchange of the property. All test and imputation rates are applied using semiannual compounding.

"Test rates" and "imputation rates"

General rule.—For sales or exchanges after December 31, 1984, of new property eligible for the investment credit, and for all sales or exchanges after June 30, 1985, the test rate is 110 percent of the [13] "applicable Federal rate," and the imputation rate is 120 percent of the "applicable Federal rate."

Special rule for certain transactions before July 1, 1985.—For sales or exchanges after December 31, 1984, and before July 1, 1985, of property other than new property eligible for the investment credit, the test rate for "borrowed amounts" not exceeding $2 million is 9 percent. The test rate for borrowed amounts exceeding $2 million is a "blend" of 9 percent on the first $2 million and 110 percent of the applicable Federal rate (the "AFR") on the excess. In applying the $2 million limitation, all sales or exchanges that are part of the same transaction (or a series of related transactions) are treated as one transaction, and all debt instruments arising from the same transaction (or a series of related transactions) are treated as one debt instrument. The imputation rate for transactions during this same period is 10 percent for borrowed amount up to $2 million and a blend of 10 percent and 120 percent of the AFR for borrowed amounts exceeding $2 million.

Other lower test and imputation rates.—The test rate for certain sales of homes and farm property after June 30, 1985, may not exceed 9 percent. This exception generally is limited to

[1]Public Law 99-121, page 367.

$250,000 for sales of homes and $1 million for sales of farms.

Applicable Federal rate.—The applicable Federal rate ("AFR") for a debt instrument is the lower of two published rates, one specified by the Tax Reform Act of 1984 (the "1984 Act") and one specified in temporary Treasury regulations. The statutory rate is based on the weighted average of yields over a period of six months for marketable obligations of the United States Government with a comparable maturity. Such rates are redetermined at six-month intervals for three categories of debt instruments: short-term maturity (three years or less), mid-term maturity (more than three years but not in excess of nine years), and long-term maturity (more than nine years).[1]

The rates determined under the temporary Treasury regulations are intended to reflect more accurately the current marketplace.[2] These rates are computed monthly using the same methodology described above, except that the rates reflect the average yields for one-month periods. In any month, the lower of the six-month rate or the monthly rate is the AFR. However, in cases where the monthly rate for either of the two preceding months is lower than the AFR for a particular month, the test rate for that month is the lower of the two such rates.

Exceptions.—The imputed interest rules do not apply to the obligor on a debt instrument incurred in the acquisition of personal use property, to the sale of certain patents, to certain annuities, and to transactions involving a sale of property with a sales price of not more than $3,000.

[14] *Method of accounting*

Interest income and expense on debt instruments that are issued for property and that do not require the current payment of interest generally must be accounted for on the accrual method of accounting unless one of the following exceptions apply.

The accrual accounting requirement does not apply to (1) debt instruments issued for nonpublicly-traded property in transaction that are excepted from the imputed interest rules (2) debt created in the sale of certain small businesses and farms, (3) debt created in the sale of a principal residence, and (4) debt created where the total payments are less than $250,000.

Assumptions

The assumption of the following debt obligations in connection with the sale or exchange of property, or the taking of property subject to such debt obligations, does not result in the application of the imputed interest rules, provided that the terms and conditions of the obligation are not modified in connection with the sale: (1) loans that were made before October 16, 1984, and assumed after December 31, 1984, in connection with the sale of property the purchase price of which does not exceed $100 million and (2) all loans assumed in connection with the sale of a residence, certain farms, and certain trades or businesses.

House Bill

The imputed interest rules

Overview

The House bill makes four basic changes to the imputed interest rates. First, the House bill generally reduces the test rate from 110 percent of the AFR to 100 percent of the AFR. Second, the House bill provides for lower imputed interest rates for certain smaller transactions. Third, the House bill provides that the imputation rate would be the same as the test rate (i.e., there would be no higher "penalty rate" where inadequate interest is stated). Finally, the House bill revises the computation of the AFR from a semiannual rate to a monthly rate.

Lower overall imputed interest rate

Under the House bill, the imputed interest rate (i.e., the test rate and the imputation rate) is reduced to 100 percent of the AFR.

Lower imputed interest rates for certain smaller transactions

The House bill places a limit on the imputed interest rates in smaller transactions that do not involve new property eligible for the investment tax credit. Under these rules, where the amount of seller financing[3] does not exceed $2 million, the House bill provides that the imputed interest rate cannot exceed 9 percent.[4] [15] Where the amount of seller financing exceeds $2 million but is less than $4 million, the imputed interest rate cannot exceed a "blend" of 9 percent on a specified portion of the seller financing and the 100 percent of the AFR on the remainder. The portion of the seller-financing eligible for the 9 percent rate is equal to $2 million reduced dollar-for-dollar by the amount of seller financing over $2 million. Where the amount of seller financing is $4 million or more, the imputed interest rate is equal to 100 percent of the AFR. The $2 million and $4 million thresholds amounts will be indexed for inflation beginning after 1988.

For sales of new property eligible for the investment credit, the imputed interest rate for a seller-financed debt instrument is equal to 100 percent of the AFR regardless of the amount of seller financing.

Elimination of the penalty rate

Under the House bill, the imputation rate for a debt instrument that fails to state adequate interest will be the same as the test rate for that instrument. Accordingly, there is only one "imputed interest rate" for a transaction and there is no separate "penalty rate" where a debt instrument does not state adequate interest for any reason.

Determination of the applicable Federal rate

Under the House bill, the sole mechanism for determining the AFR will be the one currently prescribed by the temporary Treasury regulations. The alternative mechanism under present law for determining the six-month rate prescribed by the 1984 Act will be eliminated.

Under these revised rules, the AFR will be computed using the same methodology as under present law, except that the rates will be determined on a monthly basis and the rate will reflect the average yields for one-month peri-

[1] Appropriate adjustments to the rates are to be made for application to debt instruments, the interest on which is wholly or partly exempt from tax (sec. 1288).

[2] The mechanism provided by the temporary regulations is intended to respond to a problem that may exist where interest rates decline after the period in which the Federal rates were determined.

[3] The amount of seller financing is measured by the stated principal amount of the seller-financed debt instrument.

[4] As under present law, all rates will be compounded semiannually.

ods. In addition, the AFR for a particular month may be used as the imputed interest rate for contracts for sales or exchanges entered into in that month and the next two succeeding months.

Regulatory authority

The House bill authorizes the Treasury Department to issue regulations specifying the circumstances in which transactions will be treated as "part of the same transaction or related transactions" for the purpose of applying the $2 million and $4 million limitations. The House bill also provides that the Treasury Department is authorized to issue regulations under which taxpayers would be permitted to demonstrate that, in appropriate circumstances, a rate lower than the AFR provided by the statute, but calculated according to the same principles as the AFR,[5] is a more appropriate imputed interest rate for a particular debt instrument. Finally, the House bill authorizes the Treasury Department to issue regulations regarding the relationship of the imputed interest provisions to other Code provisions.

[16] *Method of accounting*

The House bill provides that, in the case of certain debt instruments that otherwise would be subject to the accrual accounting requirement, interest income and expense arising from such debt instruments may be accounted for on the cash receipts and disbursements methods of accounting. To be eligible for such treatment, (1) the stated principal amount of the debt instrument cannot exceed $2 million, (2) the debt instrument must arise from the sale of property by a cash-basis taxpayer who is not a dealer in the type of property sold, and (3) the lender and the borrower must jointly elect such treatment. A debt instrument meeting these requirements is to be known as a "cash-method debt instrument."

Special rules are provided relating to the treatment of taxpayers who are the successors to either the issuer or holder of a cash-method debt instrument. The Treasury Department is authorized to issue regulations prescribing rules to prevent abuses of the special treatment afforded to cash-method debt instruments.

[5]That is, a rate that is calculated by reference to Treasury obligations with similar maturity.

Assumptions

Under the House bill, if an existing debt instrument is assumed in connection with the sale or exchange of property (or if the property is acquired subject to an existing debt instrument), the imputed interest rules will not apply to such existing debt instrument by reason of such assumption (or acquisition) unless either the terms of the existing debt instrument are modified in connection with the transaction or the nature of the transaction is changed.

Effective date

The provisions of the House bill relating to the amendment of the imputed interest rules are effective for sales or exchanges occurring after June 30, 1985.

Senate amendment

The imputed interest rules

The Senate amendment generally follows the House bill with certain modifications. Under the Senate amendment, in general, the amount of seller financing that would be eligible for the 9 percent rate is $2 million for all transactions where the amount of seller financing does not exceed $4 million. In transactions involving the sale of farm property or real property used in certain closely held trades or businesses, $2 million of seller financing would be eligible for the 9 percent rate, provided the total amount of seller financing did not exceed $9 million. Also under the Senate amendment, an imputed interest rate of 110 percent of the AFR would apply to any sale-leaseback transaction or any transaction involving a sales price in excess of $25 million. In addition, where the AFR exceeded 12 percent, the imputed interest rate for certain transactions would be limited to the sum of 12 percent and one-third of the excess of the AFR over 12 percent.

The authority granted to the Treasury Department to provide regulations that would permit taxpayers to prove that a lower im- [17] puted interest rate is appropriate would be effective as if it were contained in the 1984 Act.

Method of accounting

The Senate amendment is the same as the House bill.

Assumptions

The Senate amendment is the same as the House bill.

Conference agreement

The imputed interest rules

The conference agreement generally follows the House bill with the following modifications. Under the conference agreement, where the amount of seller financing does not exceed $2,800,000, the imputed interest rate generally may not exceed 9 percent. Where the amount of seller financing is greater than $2,800,000, the imputed interest rate is generally 100 percent of the AFR. An imputed interest rate of 110 percent of the AFR, however, applies to sale-leaseback transactions. Indexing of the $2,800,000 threshold for the 9 percent rate (and the $2 million threshold for the 9 percent rate (and the $2 million threshold for cash-method debt instruments) begins after 1989.

The effective date of the regulatory authority relating to the use of lower imputed interest rate is the same as in the Senate amendment. In this regard, the conferees intend that the regulatory authority be exercised in a manner so that the lower rate would be permitted only in circumstances where it can be demonstrated that both the rate recalculated based on the same principles as the AFR and the rate at which the borrower can borrow funds on an arm's length basis is lower than the AFR that otherwise would be applicable to the borrower's debt instrument. Further, it is intended that the rate permitted under the regulations would be not less than the borrower's arm's length borrowing rate.

The conferees understand that where a sale or exchange takes place after June 30, 1985, pursuant to a binding contract entered into on or before that date, the imputed interest rates for such a transaction are to be determined pursuant to the provisions of the conference agreement using the applicable Federal rates in effect on the date the binding contract was entered into. For example, if a seller executes a binding contract on March 15, 1985, with a buyer to purchase nonpublicly-traded property with seller financing of $3 million and the transaction is closed on July 15, 1985, the test rate is 100 per-

cent of the AFR for March 15, 1985.

Under the conference agreement, the imputed interest rules will not be applied to the issuance or modification of certain specified debt instruments held by the New York State Mortgage Loan Enforcement and Administration Corporation provided such issuance or modification is in connection with the workout of such debt instruments and the principal amount of indebtedness resulting from such workout does not exceed the sum (as of the time of the workout) of the outstanding principal amount of the specified debt instrument and any arrearages thereon. The conferees understand that the rate of interest charged with respect to the arrearages shall be not less than the rate on the related loan. The conferees [18] intend no inference in adopting this provision regarding the appropriate income tax treatment of such debt instruments or of other debt instruments in similar circumstances. Specifically, the conferees intend that no inferences be taken from the adoption of this provision that any arrangements existing prior to or resulting from these workout agreements is properly considered as debt for tax purposes.

Method of accounting

The conference agreement is the same as the House bill and the Senate amendment.

Assumptions

The conference agreement is the same as the House bill and the Senate amendment. The conferrees are concerned about the extend to which the assumption rules apply when the terms of the debt are modified. The conferees expect that the Treasury Department will issue regulations, consistent with the purposes of these provisions, regarding the proper tax treatment of all parties in transactions where the terms and conditions of the obligation are modified or changed in connection with the transfer of property.

B. Accelerated Cost Recovery System

Present law

In general, domestic real property placed in service after March 15, 1984, and qualifying as recovery property, may be depreciated on an accelerated basis under ACRS over an 18-year period, under tables of recovery percentages prescribed by the Treasury Department. These tables reflect a "mid-month" convention for property placed in service after June 22, 1984. Taxpayers may also elect to depreciate such property on a straight-line basis over 18, 35, or 45 years. The recovery period under ACRS for low-income housing described in sections 1250(a)(1)(B)(i), (ii), (iii) or (iv) is 15 years and no mid-month convention is used.

Under transitional ruels provided by the 1984 Act, property placed in service after March 15, 1984, pursuant to binding contracts entered into, or where construction was commenced by or for the taxpayer, prior to March 16, 1984, may be eligible for a 15-year recovery period. Special rules under the 1984 Act are also provided relating to components of real property placed in service prior to March 16, 1984, that are placed in service on or after that date.[6]

House bill

Under the House bill, the minimum recovery period for domestic real property qualifying as recovery property generally is increased from 18 years to 19 years. However, this change in the recovery period does not affect the ACRS provisions relating to low-income housing (the recovery period of which remains at 15 years).

The provision of the House bill relating to the ACRS recovery period for real property is generally effective for property placed in [19] service after May 8, 1985. Transitional rules similar to those under the 1984 Act are provided for property that is placed in service after May 8, 1985, and before January 1, 1987, where there was a binding contract to construct or acquire the property, or where construction was begun by or for the taxpayer before May 9, 1985. Special rules apply to components placed in service after May 8, 1985.[7]

Senate amendment

The Senate amendment is the same as the House bill with the exception that a conforming amendment relating to the eligibility of lessee-incurred costs for the rehabilitation tax credit (secs. 46 and 48(g)) is not effective for leases executed prior to May 22, 1985, if the lessee signed the lease before May 17, 1985.

Conference agreement

The conference agreement is the same as the Senate amendment. The conferees intent that the recovery percentages to be computed by the Treasury Department be done on a more exact basis than is current practice. Specifically, if the Treasury Department provides that depreciation may be calculated by applying specified percentages to the basis of the property, the conferees intend that the percentage be expressed to at least the nearest tenth of a percentage point. Similarly, separate percentage rates should be provided for each month during a taxable year during which the property may be placed in service.

II. BELOW-MARKET LOAN PROVISIONS

Present law

Section 7872 of the Code, added by the 1984 Act, generally provides that certain loans that bear interest at a below-market rate, are to be treated as loans bearing interest at the market rate accompanied by a payment or payments from the lender to the borrower which are characterized in accordance with the substance of the particular transaction (e.g., gift, compensation, dividend, etc.). The market rate of interest for purposes of section 7872 is assumed to be 100 percent of the AFR at the time the loan is made in the case of a term loan or, in the case of a demand, 100 percent of the AFR in effect over the time that the loan is outstanding. The monthly rate provided by the temporary Treasury regulations under the imputed interest rules does not apply for this purpose

Section 7872 applies to (1) loans where the foregone (i.e., below-market) interest is in the nature of a gift, (2) loans to an employee from an employer or to an independent contractor from one for whom the independent contractor provides services, (3) loans between a corporation and a shareholder of the corporation, (4) loans of which one of the principal purposes of the interest arrangement is the avoidance of any Federal tax, and (5) to the

[6] Sec. 168(f)(1).
[7] Sec. 168(f)(1).

extent provided in Treasury regulations, any below-market loan if the interest arrangement of such loan has a significant effect on any Federal tax [20] liability of either the lender or borrower. The provisions of section 7872 generally apply to term loans made after June 6, 1984, and to demand loans made after that date (or demand loans outstanding after June 6, 1984, which are not repaid before September 17, 1984). However, the below market loan rules do not apply to loans made to elderly care facilities before June 6, 1984, that are contingent on the continued residence of the lender at the facility. The application of section 7872 is limited by certain *de minimis* exceptions and, for certain gift loans, by the net investment income of the borrower. In addition, transactions covered by the last category above (i.e., number 5) would not be effective prior to the issuance of such Treasury regulations.

Below-market loans made by individuals pursuant to arrangements providing for the satisfaction of personal needs in retirement may be considered to come within either of the last two categories.

House bill

No provision.

Senate amendment

Loans to continuing care facilities

Overview

Under the Senate amendment, certain below-market loans to a "continuing care facility," made pursuant to a "continuing care contract" are excepted from the below-market loan provisions of the Code. Thus, under the Senate amendment, such loans will not be treated as bearing an interest rate equal to the applicable Federal rate and no additional payments will be treated as made from the lender to the borrower. Loans to continuing care facilities pursuant to continuing care contracts would be subject to the below-market loan provisions to the extent that the criteria for the exception are not met.

Continuing care contract

A continuing care contract is an arrangement between an individual or a married couple and a continuing care facility that meets five requirements. Under the first requirement, a retired individual or couple must be entitled to the use of the continuing care facility for the remainder of the individual's life or both married spouses' lives. Under the second requirement, such use must commence with residence in a separate, independent living unit provided by the continuing care facility.

Under the third requirement, during the period in which the individuals reside in the independent living units, the continuing care facility must be obliged to provide such individuals with various "personal care" services. Under the fourth requirement, the continuing care facility must also undertake to provide long-term nursing care for those individuals who are no longer capable of living independently, even with the aid of personal care services. Under the fifth requirement, the continuing care contract must require the continuing care facility to provide the personal care and [21] long-term nursing services without substantial additional cost to the individual (i.e., there must be a significant insurance-like element for the individual).

Continuing care facility

A continuing care facility is one or more facilities that are designed to provide services under continuing care contracts and substantially all of the residents of which have entered into continuing care contracts.

Limitations

The exception is available for a loan only as of the calendar year in which the lender has attained age 65. A loan from either or both members of a married couple where only one spouse has attained age 65 will be treated as qualifying for the exception if both of the spouses are to reside in the continuing care facility. The exception applies only to the extent that the principal amount of a loan, when added to the aggregate outstanding amount of all other previous loans between the lender (or if the lender is married, the lender and the lender's spouse) to any continuing care facility, does not exceed $90,000. This amount is indexed for inflation.

Special rule for certain payments

Payment arrangements meeting specified requirements, between an individual and an elderly care facility meeting specified requirements are not treated as loans for purposes of the below-market loan rules. In general, the payment arrangement is one where an initial payment and a portion thereof that is refundable is based on the fair market value of residential accommodations supplied to the individual by the elderly care facility.

Effective date

The provisions of the Senate amendment relating to below-market loans to continuing care facilities pursuant to continuing care contracts are generally effective with respect to such loans that are made after the date of enactment. All such loans made on or before the date of enactment are excepted from the below-market loan rules. In addition, any Treasury regulations relating to the application of the below-market loan rules to loans made to any elderly care facilities are prohibited from taking effect prior to January 1, 1986.

Employee relocation loans

The Senate amendment modifies the below-market loan rules with respect to so-called "employee relocation loans." An employee relocation loan is a loan from an employer to an employee, the proceeds of which are used by the employee toward the purchase of a principal residence in connection with commencement of work by the employee at a new principal place of work. The purchase of the principal residence must occur in a situation where any moving expenses incurred by the employee would be deductible under section 217 of the Code.

In the case of such employee relocation loans, the rate used for determining whether the loan is a below-market loan to which ad- [22] ditional interest will be imputed, is the AFR for the month in which the employee enters into a written contract for the purchase of the principal residence, rather than the month in which the loan is made.

The provisions of the Senate amendment relating to employee relocation loans are effective for loans made pursuant to purchase contracts entered into after June 30, 1985.

Conference agreement

Loans to continuing care facilities

The conference agreement generally follows the Senate amendment with certain modifications. First, the requirement that the continuing care facility own or operate substantially all the facilities used to provide services under a continuing care contract is effective without regard to when a facility began operating (or a contract for the construction of the facility was entered into). Second, no restrictions are placed on the effective date of any Treasury regulations relating to the application of the below-market loan rules to loans made to elderly care facilities.

The provision in the Senate amendments relating to whether specified payment arrangements are to be treated as loans for purposes of the below-market loan rules is limited to three specified elderly care facilities that would not qualify as continuing care facilities under the Senate amendment. In this regard, the conferees confirm that the below-market loan rules of the 1984 Act and the changes made to those rules by this bill only apply to transactions that are loans for Federal income tax purposes. The conferees specifically intend that the provisions of the bill do not define, and do not alter, the prior law rules relating to what transactions are, or are not, to be treated as loans. In addition, the conferees understand that a payment to a continuing care facility pursuant to a continuing care contract frequently is wholly or partially refundable for a relatively brief period (e.g., six months) essentially for consumer protection purposes pursuant to State law or regulations. The conferees also understand that payments to a continuing care facility are often refundable on a declining pro rata basis over a somewhat longer period (often up to eight years). The conferees understand that such payments ordinarily would be treated as the advance payment of fees and not as loans under present law.

In addition, certain technical modifications have been made to the language contained in the Senate amendment.

[23] *Employee relocation loans*

The conference agreement follows the Senate amendment.

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Part III. Administrative, Procedural, and Miscellaneous

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Delegation Order No. 156 (Rev. 6) (Effective August 1, 1985)

Authority To Permit Disclosure of Tax Information and To Permit Testimony or the Production of Documents

Pursuant to the authority vested in the Commissioner of Internal Revenue by Treasury Department Order No. 156-37 and in the Chief Counsel by General Counsel Order 4, and by Treasury Department Order No. 190 (as revised), authority to act in matters officially before their respective functions is hereby delegated.

The authority to disclose returns and/or return information under certain provisions of the IR Code, such as IRC 6103(h)(1) and (k)(6) is not delegated herein as the language of these provisions themselves permits officers and employees of the Internal Revenue Service and the Office of the Chief Counsel to disclose such information. The authority to disclose returns and return information under IRC 6103(k)(4) is also not delegated herein as Delegation Order 114 (as revised) [1982-1 C.B. 341] governs these disclosures.

(1) The Deputy Commissioner; Associate Commissioners; Assistant Commissioners; Deputy Assistant Commissioners; Division Directors (or equivalent level position); Assistant Director, Disclosure and Security Division; Deputy Chief Counsel; Associates Chief Counsel; Deputy Associates Chief Counsel; Chief Counsel Division Directors; Regional Commissioners; Regional Inspectors; Regional Counsels; Deputy Regional Counsels; District Counsels; District and Service Center Directors; Director, National Computer Center; and Director, Data Center are authorized:

(a) To disclose or, in specific instances, authorize the disclosure of returns or return information to such persons as the taxpayer may designate in a written request, subject to the conditions prescribed in IRC 6103(c) and the Treasury Regulations thereunder. The authority to withhold return information upon a determination that such disclosure would seriously impair Federal tax administration is also delegated. The authority delegated in this paragraph to disclose returns or return information may be redelegated to Internal Revenue Service employees and employees of the Office of Chief Counsel to the extent necessary within the exercise of their official duties. The authority delegated in this paragraph to withhold return information may be redelegated not lower than Chiefs, Special Procedures function; Group Managers (or their equivalent); Chiefs, Appeals Offices; Chiefs, Criminal Investigation Branch; and Disclosure Officers.

(b) To disclose or, in specific instances, authorize the disclosure of returns, upon the written request of an individual taxpayer, partner, corporate officer, shareholder, administrator, executor, trustee, or other person having a material interest subject to the conditions prescribed in IRC 6103(e). The authority to disclose or, in specific instances, authorize the disclosure of return information to such persons, upon a determination that disclosure would not seriously impair Federal tax administration, as prescribed in IRC 6103(e)(7), is also delegated. The authority to withhold return information upon a determination that disclosure would seriously impair Federal tax administration is also delegated. The authority delegated in this paragraph to disclose or authorize the disclosure of returns or return information may be redelegated to Internal Revenue Service employees and employees of the Office of Chief Counsel to the extent necessary within the exercise of their official duties. In the event a disclosure of return information would seriously impair Federal tax administration, the decision to withhold such return information will be referred to officials not lower than Chiefs, Special Procedures function; Group Managers (or their equivalent); Chiefs, Appeals Officers; Chiefs, Criminal Investigation Branch; and Disclosure Officers.

(c) To disclose or, in specific instances, authorize the disclosure of returns or return information to officers and employees of the Department of Justice including United States attorneys, in a matter involving tax administration, subject to the conditions prescribed in IRC 6103(h)(2), the Treasury Regulations thereunder, and (h)(3)(A). The authority delegated in this paragraph may be redelegated not lower than Chiefs, Special Procedures function; and Group Managers (or their equivalent including Disclosure Officers). The authority delegated in this paragraph to Chief Counsel employees may be redelegated not lower than Chiefs, Appeals Officers; and to attorneys of the Office of Chief Counsel directly involved in such matters. (See paragraph (17) below.)

(d) To disclose or, in specific instances, authorize the disclosure of returns or return information to officers and employees of the Department of Treasury, as specified in IRC 6103(i)(4)(B) or, upon written request, to employees and other persons specified in IRC 6103(l)(4)(A) for use in personnel or claimant representative matters, and to make relevancy and materiality determinations as provided in section 6103(l)(4)(A), subject to the conditions prescribed in IRC 6103(l)(4). The authority delegated in this paragraph may be redelegated only to Assistant Division Directors (or equivalent level position); Assistant Regional Commissioners; Regional Director of Appeals; Assistant Regional Inspectors; Regional Chief, Personnel Branch; Assistant District and Service Center Directors; Division Chiefs; National Office Branch Chiefs, Internal Security Division; Staff Assistants to Regional Counsels; and to attorneys of the Office of Chief Counsel and inspectors directly involved in such matters. (See paragraph 13(e).)

(e) To disclose or, in specific instances, authorize the disclosure of returns or return information to the extent necessary in connection with contractual procurement by the Service or Office of the Chief Counsel of equipment or other property or services, subject to the conditions prescribed in IRC 6103(n) and the Treasury Regulations thereunder. The authority delegated in this paragraph may be redelegated only to Assistant Division Directors (or equivalent level position); Assistant Regional Commissioners; Regional Director of Appeals; Assistant Regional Inspectors; Assistant District and Service Center Directors; Division Chiefs; Chief Counsel Assistant Division Directors; Associate Regional Counsel;

and Disclosure Officers.

(f) To disclose, or in specific instances, authorize the disclosure of return information (other than taxpayer return information) which may constitute evidence of a violation of any Federal criminal law (not involving tax administration) or to disclose return information under circumstances involving a threat or other imminent danger of death or other physical injury, which is directed against the President or other government official, to the U.S. Secret Service, subject to the conditions prescribed in IRC 6103(l)(3). The authority delegated in this paragraph is also delegated to Assistant District and Service Center Directors. This does not limit the authority granted in paragraph 6(d) of this order.

(g) To determine whether a disclosure of standards used or to be used for selection of returns for examination, or data used or to be used for determining such standards will seriously impair assessment, collection or enforcement under the internal revenue laws pursuant to IRC 6103(b)(2). The authority delegated in this paragraph may be redelegated to Disclosure Officers.

(2) The Deputy Commissioner; Associate Commissioners; Assistant Commissioners; Deputy Assistant Commissioners; Division Directors (or equivalent level position); Assistant Director, Disclosure and Security Division; Regional Commissioners; Regional Inspectors; District and Service Center Directors; Director, National Computer Center, and Director, Data Center are authorized to determine whether a disclosure of returns or return information in a Federal or State judicial or administrative proceeding pertaining to tax administration would identify a confidential informant or seriously impair a civil or criminal tax investigation, subject to the conditions prescribed in IRC 6103(h)(4). The authority delegated in this paragraph may not be redelegated.

(3) The Deputy Commissioner; Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); Regional Commissioners; Director, Disclosure and Security Division; Assistant Director, Disclosure and Security Division; and District and Service Center Directors are authorized;

(a) To furnish an affirmative or negative response to a written inquiry from an attorney of the Department of Justice (including a United States Attorney) involved in a judicial proceeding pertaining to tax administration, or any person (or his/her legal representative) who is a party to such proceeding, as to whether a prospective juror has or has not been the subject of any audit or other tax investigation by the Internal Revenue Service, subject to the conditions prescribed in IRC 6103(h)(5). The authority delegated in this paragraph may be redelegated only to Assistant District and service Center Directors; Division Chiefs, and Disclosure Officers.

(b) To disclose or, in specific instances, authorize the disclosure of:

(i) Accepted offers-in-compromise to members of the general public, subject to the conditions prescribed in IRC 6103(k)(1).

(ii) The amount of an outstanding obligation secured by a lien, notice of which has been filed pursuant to section 6323(f), to any person who furnishes satisfactory written evidence establishing a right in or intent to obtain a right in property subject to such lien, subject to the conditions prescribed in IRC 6103(k)(2). The authority to disclose or, in specific instances, authorize the disclosure of the amount of such outstanding obligation is also delegated to the Associate Commissioner (Operations); Assistant Commissioner (Collection); and Deputy Assistant Commissioner (Collection).

(iii) Taxpayer identity information with respect to any income tax return preparer and information as to whether any penalty hs been assessed against such preparer to officers and employees of any agency charged under State or local law with the regulation of such preparers, upon written request and subject to the conditions prescribed in IRC 6103(k)(5);

(iv) Returns or return information with respect to taxes imposed by IRC chapters 2, 21, and 24 to the Social Security Administration, upon written request and subject to the conditions prescribed in IRC 6103(l)(1)(A);

(v) Returns or return information with respect to taxes imposed by IRC chapter 22 to the Railroad Retirement Board, upon written request and subject to the conditions prescribed in IRC 6103(l)(1)(C).

(vi) Returns or return information with respect to taxes imposed by IRC subtitle E (relating to taxes on alcohol, tobacco and firearms) to officers and employees of the Bureau of Alcohol, Tobacco and Firearms, upon written request and pursuant to IRC 6103(o)(1).

The authority delegated in subparagraphs (iv) and (v) is also delegated to the Associate Commissioner (Operations); the Associate Chief Counsel (Technical); and the Assistant Commissioner (Examination). The authority delegated in this paragraph may be redelegated only to Assistant District and Service Center Directors; Division Chiefs; and Disclosure Officers. In addition, the authority delegated in subparagraph (i) may also be redelegated only to Chiefs, Special Procedures function; Special Procedures function Advisor Reviewers; and Group Managers (or their equivalent). The authority delegated in subparagraph (ii) may also be redelegated only to Chiefs, Special Procedures function; Special Procedures function Advisor Reviewers; Group Managers (or their equivalent); and Revenue Officers. The authority delegated in subparagraph (iv) may be redelegated not lower than Branch Chief.

(4) The Deputy Commissioner; Regional Commissioner; District and Service Center Directors are authorized to disclose or, in specific instances, authorize the disclosure of returns or return information to designated State tax officials, upon written request by the head of a State tax agency, for the purpose of and to the extent necessary in the administration of State tax laws, pursuant to the provisions of IRC 6103(d) and subject to the conditions prescribed in IRC 6103(h)(4) and (p)(8). The authority to withhold return information pursuant to IRC 6103(d) and (h)(4) upon a determination that such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation is also delegated. The authority delegated in this paragraph does not extend to the entry into Federal/State Agreements on the Coordination of Tax Administration. The authority delegated in this paragraph may be redelegated to any supervisory level deemed appropriate, but such redelegation shall not extend to the authority to withhold return

information.

(5) The Deputy Commissioner; Regional Commissioners; District and Service Center Directors; and Director, National Computer Center are authorized to disclose or, in specific instances, authorize, the disclosure of returns or return information pursuant to Federal/State Agreements on the Coordination of Tax Administration entered into between the head of any State tax agency and the Commissioners of Internal Revenue, pursuant to the provisions of IRC 6103(d) and subject to the conditions prescribed in IRC 6103(h)(4) and (p)(8). The authority to withhold return information pursuant to IRC 6103(d) and (h)(4) upon a determination that such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation is also delegated. The authority delegated in this paragraph may be redelegated to any supervisory level deemed appropriate, but such redelegation shall not extend to the authority to withhold return information.

(6) The Deputy Commissioner; Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); Director, Disclosure and Security Division; and Assistant Director, Disclosure and Security Division are authorized:

(a) To disclose or, in specific instances, authorize the disclosure of returns and return information to Congressional committees and other persons, upon written request and subject to the conditions prescribed in IRC 6103(f). The authority delegated in this paragraph is also delegated to the Assistant to the Commissioner (Legislative Liaison). The authority delegated in this paragraph may not be redelegated.

(b) To disclose or, in specific instances, authorize the disclosure of returns or return information to officers and employees of a Federal agency pursuant to an *ex parte* order by a Federal District Court judge or magistrate when needed for use in the enforcement of a Federal criminal statute (not involving tax administration), or to locate a fugitive from justice subject to the conditions prescribed in IRC 6103(i)(1) or (i)(5) and the Treasury Regulations hereunder. The authority to withhold any return or return information, pursuant to IRC 6103(i)(6), upon a determination that such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation is also delegated. The authority delegated in this paragraph is also delegated to Regional Commissioners; District and Service Center Directors; and Assistant District and Service Center Directors. This authority may not be redelegated.

(c) To disclose or, in specific instances, authorize the disclosure of return information (other than taxpayer return information) to officers and employees of a Federal agency upon written request by the head of such agency or the Inspector General thereof, or in the case of the Department of Justice, the Attorney General, the Deputy Attorney General, the Associate Attorney General, any Assistant Attorney General, the Director of the Federal Bureau of Investigation, the Administrator of the Drug Enforcement Administration, any United States attorney, any special prosecutor appointed under section 593 of title 28, United States Code, or any attorney in charge of a criminal division organized crime strike force established pursuant to section 510 of title 28, United States Code, when needed for use in the enforcement of a Federal criminal statute (not involving tax administration), subject to the conditions prescribed in IRC 6103(i)(2). The authority to withhold return information (other than taxpayer return information), pursuant to IRC 6103(i)(6), upon a determination that such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation is also delegated. The authority delegated in this paragraph is also delegated to Regional Commissioners; District and Service Center directors; and Assistant District and Service Center Directors. This authority may not be redelegated.

(d) To disclose or, in specific instances, authorize the disclosure of:

(i) Return information (other than taxpayer return information) which may constitute evidence of a violation of Federal criminal law (not involving tax administration) to the extent necessary to apprise the head of the appropriate Federal agency pursuant to IRC 6103(i)(3)(A);

(ii) Return information to the extent necessary to apprise appropriate officers or employees of a Federal or State law enforcement agency of circumstances involving an imminent danger of death or physical injury to any individual pursuant to IRC 6103(i)(3)(B)(i);

(iii) Return information to the extent necessary to apprise appropriate officers or employees of a Federal law enforcement agency of circumstances involving the imminent flight of an individual from Federal prosecution pursuant to IRC 6103(i)(3)(B)(ii);

With respect to subparagraph (i), the authority to withhold any return information pursuant to IRC 6103(i)(6) upon a determination that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation is also delegated.

The authority delegated in this paragraph is also delegated to Regional Commissioners; District and Service Center Directors; and Assistant District and Service Center directors. The authority delegated in this paragraph may be redelegated only to the Assistant Director, Disclosure and Security Division; and Branch Chiefs and Section Chiefs, Disclosure and Security Division, but such redelegation shall not extend to the authority to withhold return information (other than taxpayer return information). This authority is in addition to the authority previously delegated in paragraph (1)(f).

(e) To notify the Attorney General or his delegate of the head of a Federal agency that certain returns or return information obtained pursuant in IRC 6103(i)(1), (2) or (3)(A) shall not be admitted into evidence under IRC 6103(i)(4)(A)(i) or (B), upon a determination, in accordance with IRC 6103(i)(4)(C), that such admission would identify a confidential informant or seriously impair a civil or criminal tax investigation. The authority delegated in this paragraph is also delegated to Regional Commissioners; District and Service Center Directors; and Assistant District and Service Center Directors. This authority may not be redelegated.

(f) To disclose or, in specific instances, authorize the disclosure of returns or return information to officers and employees of the General Accounting Office, upon written request by the Comptroller General of the Untied States and subject to the conditions pre-

scribed in IRC 6103(i)(7). The authority to withhold any return or return information, pursuant to IRC 6103(i)(6), upon a determination that such disclosure would impair any civil or criminal tax investigation or reveal the identity of a confidential informant is also delegated. The authority delegated in this paragraph may not be redelegated.

(g) To disclose or, in specific instances, authorize the disclosure of:

(i) The mailing address of taxpayer to officers and employees of an agency when needed in connection with a Federal claim against such taxpayer, upon written request to the conditions prescribed in IRC 6103(m)(2). The authority delegated in this paragraph is also delegated to Regional Commissioners, District and Service Center Directors; and Assistant District and Service Center Directors. Upon approval of a contractual agreement to such disclosures, the authority delegated in this paragraph is also delegated to the Assistant Commissioner (Returns and Information Processing); Deputy Assistant Commissioner (Returns and Information Processing); Director, Returns Processing and Accounting Division; and Director National Computer Center. The authority delegated in this paragraph may be redelegated only as set forth below. The authority delegated in this paragraph to the Director, Disclosure and Security Division and the Assistant Director, Disclosure and Security Division may be redelegated only to the Branch Chiefs and Section Chiefs, Disclosure and Security Division. The authority delegated to the Regional Commissioners; Director, National Computer Center; District and Service Center Directors; and Assistant District and Service Center Directors may be redelegated only to the Disclosure Officer, National Computer Center and Regional, District and Service Center Disclosure Officers. The authority delegated in this order does not include authority to enter into a contractual agreement, which is contained in Delegation Order No. 100, as revised [1982-1 C.B. 338].

(ii) Whether or not an applicant for a loan under an included Federal loan program has a tax delinquent account to the head of the Federal agency administering such program, upon written request and subject to the conditions prescribed in IRC 6103(1)(3). The authority delegated in this paragraph is also delegated to Regional Commissioners; District and Service Center Directors; and Assistant District and Service Center Directors. Upon approval of a contractual agreement for such disclosures, the authority delegated in this paragraph is also delegated to the Assistant Commissioner (Returns and Information Processing); Deputy Assistant Commissioner (Returns and Information Processing); Director, Returns Processing and Accounting Division; and Director, National Computer Center. The authority delegated in this paragraph may be redelegated only as set forth below. The authority delegated in this paragraph to the Director, Disclosure and Security Division and the Assistant Director, Disclosure and Security Division may be delegated only to the Branch Chiefs and Section Chiefs, Disclosure and Security Division. The authority delegated to the Regional Commissioners, Director, National Computer Center; District and Service Center Directors; and Assistant District and Service Center Directors may be redelegated only to the Disclosure Officer, National Computer Center and Regional, District and Service Center Disclosure Officers. The authority delegated in this order does not include authority to enter into a contractual agreement, which is contained in Delegation Order No. 100, as revised.

(h) To disclose or, in specific instances, authorize the disclosure of the mailing address of taxpayers to officers and employees of the National Institute for Occupational Safety and Health, upon written request and subject to the conditions prescribed in IRC 6103(m)(3). Upon approval by the Director, Disclosure and Security Division or his/her delegate of a contractual agreement for such disclosures, the authority delegated in this paragraph is also delegated to the Assistant Commissioner (Computer Services); Deputy Assistant Commissioner (Computer Services); Director, Software Division; Director, National Computer Center; and Service Center Directors. The authority delegated in this paragraph to the Director, Disclosure and Security Division and the Assistant Director, Disclosure and Security Division, may be redelegated only to Branch Chiefs and Section Chiefs, Disclosure and Security Division. The authority delegated to the Assistant Commissioner (Computer Services); Deputy Assistant Commissioner (Computer Services); Director, Software Division; Director, National Computer Center; and Service Center Directors may not be redelegated. The authority delegated in this paragraph does not include authority to enter into a contractual agreement, which is contained in Delegation Order No. 100, as revised.

(i) To disclose, or in specific instances, authorize the disclosure of the mailing address of any taxpayer who has defaulted on a loan made from the student loan fund established under part B or E of title IV of the Higher Education Act of 1965 or a loan made to a student at an institute of higher education pursuant to section 3(a)(1) of the Migration and Refugee Assistance Act of 1962, to the Secretary of Education upon written request and subject to the conditions prescribed in IRC 6103(m)(4). Upon approval by the Director, Disclosure and Security Division or his/her delegate of a contractual agreement for such disclosures, the authority delegated in this paragraph is also delegated to the following officials: Assistant Commissioner (Computer Services); Deputy Assistant Commissioner (Computer Services); Director, Software Division; Director, National Computer Center; and Service Center Directors. The authority delegated in this paragraph to the Director, Disclosure and Security Division and the Assistant Director, Disclosure and Security Division, may be redelegated only to Branch Chiefs and Section Chiefs, Disclosure and Security Division. The authority delegated to the Assistant Commissioner (Computer Services); Deputy Assistant Commissioner (Computer Services); Director, Software Division; Director, National Computer Center; and Service Center Directors may not be redelegated. The authority delegated in this paragraph does not include authority to enter into a contractual agreement, which is contained in Delegation Order No. 100, as revised.

(7) The Deputy Commissioner; Associate Commissioner (Data Processing); and Assistant Commissioner (Returns and Information Processing) are authorized:

(a) To disclose or, in specific instances, authorize the disclosure of re-

turns or return information for statistical use to officer and employees of the Department of Commerce, Bureau of Census, upon the written request of the Secretary of Commerce to officers and employees of the Department of the Treasury, subject to the conditions prescribed in IRC 6103(j)(1)(A) and the Treasury Regulations thereunder and (j)(3). The authority delegated in this paragraph may be redelegated only to the Director, Statistics of Income Division.

(b) To disclose or, in specific instances, authorize the disclosure of return information for statistical use to officers and employees of the Department of Commerce, Bureau of Economic Analysis, upon the written request of the Secretary of Commerce, or to officers and employees of the Federal Trade commission, upon written request of the chairman, subject to the conditions prescribed in IRC 6103(j)(1)(B) and (j)(2) and the Treasury Regulations thereunder. The authority delegated in this paragraph may be redelegated only to the Director, Statistics of Income Division.

(8) The Deputy Commissioner, Assistant to the Commissioner (Public Affairs); Director and Assistant Director, Public Affairs Division; Regional Commissioner; and District Directors are authorized to disclose or, in specific instances, authorize the disclosure of taxpayers' names and the city, state and zip code of their mailing addresses to the press and other media for purposes of notifying persons entitled to undelivered tax refunds, subject to the conditions prescribed in IRC 6103(m)(1). The authority delegated in this paragraph may be redelegated to Assistant District Directors and Public Affairs Officers.

(9) The Deputy Commissioner, Associate Commissioner (Policy and Management); and Assistant Commissioner (Support and Services) are authorized;

(a) Upon written request of the President, to disclose, or in specific instances, authorize the disclosure of return information (other than return information that is adverse to the taxpayer) of an individual who is under consideration for appointment to a position in the executive or judicial branch of the Federal Government to the authorized representative of the Executive Office of the President or to the Federal Bureau of Investigation on behalf of the President, subject to the conditions prescribed in IRC 6103(g)(2) and (g)(4). Authority is also delegated to disclose or, in specific instances, authorize the disclosure of return information with respect to the categories of individuals discussed above to the heads of Federal agencies upon written request, or the Federal Bureau of Investigation on behalf of and upon the written request of such agency heads, subject to the conditions described in IRC 6103(g)(2) and (g)(4). Upon receipt of any request for return information under IRC 6103(g)(2), authority to notify the individuals with respect to whom the request has been made is also delegated. The authority delegated in this paragraph may be redelegated but not lower than:

(i) Deputy Assistant Commissioner (Support and Services), in the case of requests by or on behalf of the President where the return information to be disclosed is not adverse to the taxpayer.

(ii) Assistant Director, Disclosure and Security Division, in the case of requests by or on behalf of the heads of Federal agencies where the return information to be disclosed is adverse to the taxpayer;

(iii) Branch Chiefs, Disclosure and Security Division, in the case of requests by or on behalf of the heads of Federal agencies where the return information to be disclosed is not adverse to the taxpayer; and

(iv) Section Chiefs, Disclosure and Security Division, concerning the notification of individuals with respect to whom a request has been made.

(b) To make the determination that an agency, body or commission or the General Accounting Office has failed to or does not meet the requirements of IRC 6103(p)(4). Subject to the administrative review applicable to State tax agencies described in IRC 6103(p)(7), authority to withhold returns and return information from any agency, body or commission or the General Accounting Office until a determination is made that the requirements of IRC 6103(p)(4) have been or will be met is also delegated. The authority delegated in this paragraph may not be redelegated.

(10) The Deputy Commissioner; Associate Commissioner (Operations); Assistant Commissioner (Employee Plans and Exempt Organizations); Deputy Assistant Commissioner (Employee Plans and Exempt Organizations); Director, Disclosure and Security Division; Assistant Director, Disclosure and Security Division; Regional Commissioners; District Directors of Key Districts for Employee Plans and Exempt Organizations matters; Service Center Directors; Director, National Computer Center; and Director, Data Center are authorized to disclose, or in specific instances, authorize the disclosure of:

(a) Statements, notifications, reports, or other return information described in IRC 6057(d) to officers and employees of the Social Security Administration for the administration of section 1131 of the Social Security Act, upon written request and subject to the conditions prescribed in IRC 6103(1)(1)(B). The authority delegated in this paragraph to the Assistant Commissioner and Deputy Assistant Commissioner (Employee Plans and Exempt Organizations) may be redelegated, but not lower than Branch Chiefs, Employee Plans Technical and Actuarial Division. The authority delegated in this paragraph to the Director and Assistant Director, Disclosure and Security Division may not be redelegated. The authority delegated in this paragraph to Regional Commissioners may be redelegated not lower than Assistant Regional Commissioner. The authority delegated in this paragraph to the District Directors of Key Districts may be redelegated, but not below Chiefs, Technical Review Staffs, Employee Plans and Exempt Organizations Division. The authority delegated in this paragraph to Service Center Directors may be redelegated, but not lower than Section Chiefs (or their equivalent). The authority delegated in this paragraph to the Director, National Computer Center and Director Data Center may be redelegated, but not lower than Branch Chiefs (or their equivalent).

(b) Returns or return information, including compensation information, to officers and employees of the Department of Labor and Pension Benefit Guaranty Corporation for the administration of Titles I and IV of the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1], upon written request and subject to the conditions prescribed in IRC 6103(1)(2) and the Treasury Regula-

tions thereunder. The returns or return information which may be disclosed under this paragraph include:

(i) Upon specific written request, the information specified in 26 CFR 301.6103(1)(2)-1(a), 2(a), 3(b)(1), and 3(b)(2);

(ii) Upon receipt by the Commissioner of Internal Revenue of an annual written request, the information specified in 26 CFR 301.6103(1)(2)-3(a);

(iii) Upon receipt by the Commissioner of Internal Revenue of a general written request, information specified in 26 CFR 301.6103(1)(2)-3(d).

The authority delegated in this paragraph to the Assistant Commissioner and Deputy Assistant Commissioner (Employee Plans, and Exempt Organizations) may be redelegated, but not lower than Branch Chiefs, Employee Plans Technical and Actuarial Division. The authority delegated in this paragraph to the Director and Assistant Director, Disclosure and Security Division may not be redelegated. The authority delegated in this paragraph to Regional Commissioners may be redelegated not lower than Assistant Regional Commissioner. The authority delegated in this paragraph to District Directors of the Key Districts may be redelegated, but not lower than Chiefs, Technical Review Staff, Employee Plans and Exempt Organizations Division; Group Managers, Employee Plans and Exempt Organizations Division; and Employee Plans Specialist. The authority delegated in this paragraph to Service Center Directors may be redelegated, but not lower than Section Chiefs (or their equivalent). The authority delegated in this paragraph to the Director, National Computer Center and Director, Data Center may be redelegated, but not lower than Branch Chiefs (or their equivalent). The authority delegated in this paragraph is also delegated to the Director, Appeals Division; Regional Director of Appeals; Chief Appeals Office; and Associate Chief, Appeals Office and may not be redelegated.

(11) The Deputy Commissioner; Associate Commissioner (Operations); Assistant Commissioner (Employee Plans and Exempt Organizations); and Deputy Assistant Commissioner (Employee Plans and Exempt Organizations) are authorized to disclose or, in specific instances, authorize the disclosure of drafts of proposed exemptions or of proposed denials of exemption requests, denial letters, and copies of information submitted by taxpayers requesting exemptions to the proper officers of the Department of Labor for consultation and coordination as required by IRC 4975(c)(2). The authority delegated in this paragraph may be redelegated not lower than Branch Chiefs, Employee Plans Technical and Actuarial Division.

(12) Disclosure of information to appropriate Federal, State or local law enforcement officials may be made by Internal Revenue Service employees, and employees of the Office of Chief counsel, concerning non-tax crimes which do not involve return information or the income or other financial information of an individual or entity, in accordance with the provisions of Chapter (35)00 of the Disclosure of Official Information Handbook, IRM 1272. In situations where there is a question as to whether the information to be disclosed is or is not return information, such as those described in IRM 1272, the Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (support and Services); Regional Commissioners; District and Service Center Directors; and Assistant District and Service Center Directors are authorized to approve or deny such requests for disclosure. The Assistant Commissioner (Support and Services) and the Deputy Assistant Commissioner (Support and Services) should act in all such matters only after coordination with the Disclosure Litigation Division, Office of Chief Counsel. Regional Commissioners; District and Service Center Directors; and Assistant District and Service Center Directors should act in all such matters only after coordination with the Office of Regional or District Counsel, as appropriate. The authority delegated in this paragraph may not be redelegated.

(13) The authority vested in the Commissioner of Internal Revenue by 26 CFR 301.9000-1 is delegated by this Order to the Deputy Commissioner. It is also delegated to the following officials to the extent described below. [No authorization is needed in cases referred to the Department of Justice which are discussed in paragraph (1)(c) where the testimony or disclosure is made on behalf of the government.]

(a) Regional Commissioners are authorized to determine whether officers and employees of the Internal Revenue Service assigned to their regions, including employees of the Office of the Regional Counsel, but not including employees of the Regional Inspector, will be permitted to testify or produce Service records because of a request or demand for the disclosure of such records or information. The Regional Commissioners should act in all such matters only after coordination with the Office of Regional Counsel. However, the personal testimony of a Regional Commissioner shall require authorization in accordance with (b) below. The authority delegated in this paragraph may not be redelegated. (See (d) and (e) below.) The authority delegated in this paragraph shall not extend to the disclosure of Internal Revenue Service records and information in response to a subpoena or request or other order of the Tax Court. (See General Counsel Order No. 4, 44 Federal Register 58017 (1979), which provide the authority for disclosure of Internal Revenue Service records and information in tax court proceedings.)

(b) The Assistant Commissioner (Support and Services) and the Deputy Assistant Commissioner (Support and Services) are authorized to determine whether Regional Commissioners, officers and employees of the Internal Revenue Service assigned to the National Office, including employees of the Office of Chief Counsel, and employees assigned to Regional Inspectors will be permitted to testify or produce Service records because of a request or demand for the disclosure of such records or information. The Assistant Commissioner (Support and Services) or the Deputy Assistant Commissioner (Support and Services) should act in all such matters only after coordination with the Disclosure Litigation Division, Office of Chief Counsel. The authority delegated in this paragraph may not be redelegated. (See (d) and (e) below.) The authority delegated in this paragraph shall not extend to the disclosure of Internal Revenue Service records and information in response to a subpoena or request or other order of the Tax Court. (See General Counsel Order No. 4, 44 Federal Register 58017 (1979).)

(c) The District Directors and Serv-

ice Center Directors are authorized to determine whether officers and employees of the Internal Revenue Service assigned to their district or service center (including regional appellate employees located in the district) will be permitted to testify or produce Service records because of a request or demand for disclosure of such records or information. For purposes of this paragraph employees of the Office of the District Counsel come under the authority of the District Director. Employees of the Regional Inspector are covered under paragraph (b), above. The District and Service Centers Directors should act in all such matters only after coordination with the Office of the District Counsel. However, the personal testimony of a District Director or Service Center Director shall require authorization in accordance with (a) above. The authority in this paragraph may not be redelegated. (See (d) and (e) below.) The authority delegated in this paragraph shall not extend to the disclosure of Internal Revenue Service records and information in response to a subpoena or request or other order of the Tax Court. (See General Counsel Order No. 4, 44 Federal Register 58017 (1979).)

(d) The authority delegated in paragraphs (a), (b) and (c) shall not extend to testimony or the production of Service records because of a request or demand for the disclosure of such records or information:

(i) by a Congressional Committee;

(ii) Involving a disclosure to the President or certain other persons pursuant to IRC 6103(g);

(iii) Involving a disclosure to the Comptroller General pursuant to IRC 6103(i)(7); or

(iv) Involving a disclosure to correct a misstatement of fact pursuant to IRC 6103(k)(3).

(e) The Director, General Legal Services Division and Assistant Regional Counsel (GLS), with the concurrence of the Director, General Legal Services Division are authorized to determine whether officers and employees of the Internal Revenue Service, including employees of the Office of Chief Counsel, will be permitted to testify or produce internal revenue records or information because of a request or demand for the disclosure of such records or information, if the request or demand is made in connection with personnel or claimant representative matters under the jurisdiction of the General Legal Services Division for which they have been delegated authority to disclose returns or return information as described in paragraph 1(d). The authority delegated above in this paragraph to the Director, General Legal Services Division may be redelegated only to the Assistant Director, General Legal Services Division and to Branch Chiefs and attorneys of the Office of Chief counsel directly involved in such matters. This paragraph does not limit the authority granted in (a), (b), or (c) above.

(f) The authority delegated to Regional Commissioners and District and Service Center Directors in paragraphs (a) and (c) shall not extend to testimony or the production of Service records because of a request or demand for the disclosure of such records or information which may require a disclosure to a competent authority under a tax convention, whether or not such records or information were previously disclosed pursuant to such convention. The Associate Commissioner (Policy and Management), Assistant Commissioner (Support and Services) and the Deputy Assistant Commissioner (Support and Services) should act in all such matters only after authorization by the appropriate United States competent authority. (See Delegation Order 114, as revised).

(g) In addition to paragraphs (a), (b), (c) and (e) above, authority is further delegated to Regional Commissioners; Assistant Regional Commissioners (Resource Management); Regional Inspectors; Regional and District Counsel; District and Service Center Directors; and Director, Data Center, to release or, in specific instances, authorize the release of information from the leave and payroll records of employees under their jurisdiction, and to the Fiscal Management Officer to release or, in specific instances, authorize the release of information from the leave and payroll records of all employees of the National Office, when such information is requested or subpoenaed in connection with private litigation, upon determination that release of the information would not be detrimental to the Internal Revenue Service. This delegation does not include authority to release or authorize the release of information contained in official personnel folders, which is covered by IRM 0293. When any uncertainty exists as to the availability of furnishing leave and pay information in a particular case, the matter should be referred to the national Office, Attention: PM:PRF:F, with a complete report of the circumstances. The authority delegated in this paragraph may not be redelegated.

The provisions of this paragraph (13(a)-(g)) are limited to the authorization of testimony or the production of documents pursuant to a request or demand as referred to in paragraphs (d)(1)(i) and (ii) of 26 CFR 301.9000-1 and does not extend to or affect other disclosure authority previously delegated in paragraphs (6) and (9) of this order. Furthermore, in instances where it is anticipated that the testimony or production of Service records by a Chief Counsel attorney will involve matters which may fall within the attorney-client privilege, the determination of whether to waive the privilege, as well as the authority to authorize the testimony or production shall lie with the Assistant Commissioner (Support and Services) and Deputy Assistant Commissioner (Support and Services) who will act in these matters only after coordination with the Disclosure Litigation Division. In instances involving Regional or District Counsel attorneys and the attorney-client privilege, authority shall lie with the Regional Commissioner who will act in these matters only after coordination with the Regional Counsel.

(14) The Deputy Commissioner; Associate Commissioner (Data Processing); Assistant Commissioner (Computer Services); Deputy Assistant Commissioner (Computer Services); Regional Commissioners; Director, Software Division; Director, National Computer Center; and Service Center Directors are authorized to disclose or, in specific instances, authorize the disclosure of individual master file information to the head of a Federal, State or local child support enforcement agency or an authorized supervisory official under a contractual agreement entered into pursuant to Delegation Order 100, as revised, Revenue Procedure 78-10, and subject to the conditions prescribed in IRC 6103(l)(6)(A)(i). Such contractual agreement should be

entered into only after coordination with the Director or Assistant Director, Disclosure and Security Division. The authority delegated in this paragraph may be redelegated to any supervisory level deemed appropriate.

(15) The Deputy Commissioner; Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); Regional Commissioners; and Service Center directors are authorized to disclose or, in specific instances, authorize the disclosure of return information to the head of a Federal, State or local child support enforcement agency or an authorized supervisory official under a contractual agreement entered into pursuant to Delegation Order 100, as revised, Revenue Procedure 78-10, ans subject to the conditions prescribed in IRC 6103(1)(6)(A)(ii). Such contractual agreement should be entered into only after coordination with the Director, Disclosure and Security Division. The authority delegated in this paragraph may be redelegated to any supervisory level deemed appropriate.

(16) The Deputy Commissioner; Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); Regional Commissioners; Service Center Directors; Director, National Computer Center, and Director, Data Center are authorized to disclose or, in specific instances, authorize the disclosure of information returns filed pursuant to part III of subchapter A of IRC chapter 61 to designated personnel of the Social Security Administration for the purpose of carrying out an effective return processing program in accordance with section 232 of the Social Security Act and pursuant to IRC 6103(1)(5). The authority delegated in this paragraph may not be redelegated.

(17) The Deputy Commissioner, Deputy Chief Counsel and Associate Chief Counsel (Litigation) are authorized to disclose or, in specific instances, authorize the disclosure of returns and return information to the designated officers and employees of the Department of Justice pursuant to a written request from the Attorney General, the Deputy Attorney General, or an Assistant Attorney General in a matter involving tax administration, subject to the conditions prescribed in IRC 6103(h)(3)(B). The authority delegated in this paragraph may not be redelegated.

(18) The Deputy Commissioner; Associate Commissioner (Data Processing); Assistant Commissioner (Computer Services); Assistant Commissioner (Returns and Information Processing); Director, Disclosure and Security Division; Assistant Director, Disclosure and Security Division; Service Center Directors and Director, National Computer Center are authorized upon written request to disclose, or in specific instances, authorize the disclosure of return information pursuant to IRC 6103(h)(6) with respect to the address and status of an individual as a nonresident alien, citizen or resident of the United States to the Social Security Administration or the Railroad Retirement Board for purposes of carrying out responsibilities for withholding tax from social security benefits under IRC 1441.

(19) At the request of the Commissioner of Internal Revenue and with the approval of the Joint Committee on Taxation, the following officials may disclose information with respect to a specific taxpayer pursuant to IRC 6103(k)(3): Deputy Commissioner; Regional Commissioners; District and Service Center Directors; Associate Commissioner (Operations); Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Assistant Commissioner (Examination); Assistant Commissioner (Collection); Assistant Commissioner (Criminal Investigation); Assistant Commissioner (Employee Plans and Exempt Organizations); Director, Disclosure and Security Division; any individual who is specifically designated by the Commissioner of Internal Revenue. The authority delegated in this paragraph may not be redelegated.

(20) Associate Commissioner (Data Processing); Assistant Commissioner (Returns and Information Processing); Director, National Computer Center; and Director, Disclosure and Security Division, are authorized to disclose or, in specific instances, to authorize the disclosure of return information from the Information Returns Processing Master File under a contractual agreement entered into pursuant to delegation Order No. 100, as revised, and Revenue Procedure 85-21 [1985-1 C.B. 539], as revised, to Federal, State, and Local agencies administering certain welfare programs, subject to the conditions of IRC 6103(1)(7). Such contractual agreements may be entered into only after coordination with the Director, Disclosure and Security Division. The authority in this paragraph may be redelegated to any supervisory level deemed appropriate, but only by the officials named above.

(21) Delegation Order No. 156 (Rev. 5) [1984-1 C.B. 319] and Chief Counsel Order 1031.3D, effective March 15, 1984, are superseded.

Dated: July 26, 1985.

Approved:

JEAN OWENS,
Deputy Chief Counsel.

Dated: August 1, 1985.

Approved:

JAMES I. OWENS,
Deputy Commissioner.

(Filed by the Office of the Federal Register on August 9, 1985, 8:45 a.m., and published in the issue of the Federal Register for August 12, 1985, 50 F.R. 32514)

Delegation Order No. 209 (Rev. 1) (Effective August 27, 1985)

Delegation of Authority in Partnership and S Corporation Matters

Pursuant to the authority vested in the Commissioner of Internal Revenue by IRC 6223, 6224, 6232, 6243, and 6244, and Treasury Department Order 150-37:

1. Authority to sign the notice to partners or shareholders at the beginning of an administrative proceeding at the partnership or S corporation level with respect to a partnership or subchapter S item is delegated to:

a. Revenue Agents (grade GS-11 and higher), in district offices; and

b. Chief, Examination Branch (GM 512-14), in service centers.

c. Chief, Classification Section (GM 512-13), in service centers.

d. Chief, Examination Support Unit, (GM 512-13), in service centers.

e. Chief, Windfall Profit Tax Staff (GM 512-13), in the Austin Service Center.

2. Authority to sign the notice of final partnership or S corporation admin-

istration adjustment is delegated to:

a. Chief Counsel;

b. Regional Counsel;

c. Regional Directors of Appeals;

d. Chiefs and Associate Chiefs of Appeals Offices;

e. Appeals Team Chiefs as to their respective cases;

f. Revenue Agents (Reviewers), (grade GS-11 and higher), in Examination Division;

g. Chief, Examination Branch, in service centers;

h. Chief, Classification Section (GM 512-13) in service centers; and

i. Chief, Examination Support Unit (GM 512-13), in service centers;

j. Chief, Windfall Profit Tax Staff (GM 512-13), in the Austin Service Center.

3. Authority to enter into and approve a written settlement agreement with one or more partners or shareholders with respect to the determination of partnership or S corporation items for such partnership or S corporation taxable year is delegated to:

a. Chief, Counsel;

b. Regional Counsel;

c. Regional Directors of Appeals;

d. Chiefs and Associate Chiefs of Appeals Office;

e. Appeals Team Chiefs as to their respective cases;

f. Revenue Agents (Reviewers), (grade GS-11 and higher), in Examination Division;

g. Chief, Examination Branch, (GM 512-14) in service centers;

h. Chief, Classification Section (GM 512-13), in service centers, and

i. Chief, Examination Support Unit, (GM 512-13), in service centers.

j. Chief, Windfall Profit Tax Staff (GM 512-13), in the Austin Service Center.

The authority delegated herein may not be redelegated.

Delegation Order No. 209, [1985-1 C.B. 425], effective January 9, 1985, is hereby superseded.

Dated: August 9, 1985.

Approved:

JAMES I. OWENS,
Deputy Commissioner.

(Filed by the Office of the Federal Register on September 5, 1985, 8:45 a.m., and published in the issue of the Federal Register for September 6, 1985, 50 F.R. 36509)

Delegation Order No. 213 (Effective September 4, 1985)

Authority to Issue Formal Document Requests

The authorities granted to the Commissioner of Internal Revenue by 26 CFR 301.7602-1 and section 982 of the Internal Revenue Code to issue Formal Document Requests and to perform the other functions related thereto are delegated to all District Directors, Service Center Directors, and the following officers and employees:

(1) *District Examination:* Chiefs of Division; Chiefs of Examination Section; Chiefs of Examination Branches; Case Managers; Group Managers; Internal Revenue Agents; Tax Auditors; Attorneys, Estate Tax; and Estate Tax Examiners.

(2) *District Employee Plans and Exempt Organization:* Chief of Division; Branch Chief; Chief, Technical/Review Staff; Group Managers; Internal Revenue Agents; Tax Law Specialists; and Tax Auditors.

(3) *District Collection Activity:* Chiefs and Assistant Chiefs of Divisions; Chiefs of Field Branches; Chiefs, Automated Collection Branch; Chiefs, Special Procedures Staffs; Chiefs, Technical and Office Compliance Branches and Groups; Chiefs, Collection Section; Chiefs, Collection and Taxpayer Service Section; Group Managers; Revenue Officers; Revenue Representatives; and Office Collection Representatives.

(4) *District Criminal Investigation:* Chief and Assistant Chief of Division; Chiefs of Branches; Group Managers; and Special Agents.

(5) *Inspection:* Assistant Commissioner; Director, Internal Security Division; Director, Internal Audit Division; Regional Inspectors, Internal Auditors and Internal Security Inspectors; Investigators (Internal Security); and Internal Security Assistants.

(6) *Service Center:* Chief, Compliance Division; Chief, Examination Branch; Chief, Collection Branch; Chief, Criminal Investigation Branch; Revenue Agents; Tax Auditors; Tax Examiners in the correspondence examination function; and Special Agents.

(7) *Foreign Operations District:* Director, Assistant Director; Chief of Divisions and Branches; Special Agents; Case Managers; Group Managers; Internal Revenue Agents; Attorneys Estate Tax; Estate Tax Examiners; Revenue Service and Assistant Revenue Service Representatives; Tax Auditors; and Revenue Officers.

The authority delegated herein may not be redelegated.

To the extent that the authority previously executed consistent with this Order may require ratification, it is hereby approved and ratified.

Dated: July 5, 1985.

Approved:

JAMES I. OWENS,
Deputy Commissioner.

(Filed by the Office of the Federal Register on September 10, 1985, 8:45 a.m., and published in the issue of the Federal Register for September 11, 1985, 50 F.R. 37108)

Establishment of Office; District Counsel; Anchorage, AK

Notice 85-13

AGENCY: Chief Counsel, Internal Revenue Service, Treasury.

ACTION: Establishment of office.

SUMMARY: As a result of the increasing legal casework in the State of Alaska, the Chief Counsel of the Internal Revenue Service will open a new office in Anchorage, to be known as the District Counsel, Anchorage, effective July 8, 1985.

Jean Owens,
Deputy Chief Counsel.

(Filed by the Office of the Federal Register on July 2, 1985, 8:45, a.m., and published in the issue of the Federal Register for July 3, 1985, 50 F.R. 27525)

Plan Amendments to comply with TEFRA and Certain Other Qualification Requirements

Notice 85-14

Notice 83-4, 1983-1 C.B. 532, described the time periods within which plans must be amended to conform to TEFRA, Pub. L. 97-248, 1982-2 C.B. 462, as well as certain other requirements of the law. The notice indicated a plan generally must be amended no later than the end of the first plan year beginning after 1983.

Amendments to section 1.401(b)-1 of the Income Tax Regulations, contained in T.D. 7997, 1985-1 C.B. 136,

provide that a plan provision which results in the failure of the plan to meet the qualification requirements of the Internal Revenue Code because of a change effected by TEFRA is considered a disqualifying provision for which there is a remedial amendment period during which the plan may be retroactively amended to satisfy the qualification requirements of the Code. The regulations generally allow more time for conforming to TEFRA than Notice 83-4. Accordingly, Notice 83-4 is hereby modified to provide that plans may be amended to meet the TEFRA requirements during the remedial amendment period specified in section 1.401(b)-1 of the regulations.

As indicated in Notice 85-5, 1985-1 C.B. 427, the Service has determined that this remedial amendment period will be applied as if the employer applied for, and received, an automatic extension of time for filing tax returns, pursuant to section 6081 of the Code, and section 1.6081 of the Income Tax Regulations, whether or not such a request for an extension of time actually has been filed. For example, calendar year corporate taxpayers will have until September 15, 1985 to amend plans to comply with TEFRA.

Notice 83-4 is further modified to provide that pursuant to the authority contained in section 7805(b), plans are not required to be amended to conform to the following requirements until the time they are required to conform to TEFRA: (1) final regulations under section 401(j) (concerning defined benefit plans covering self-employed individuals or shareholder employees) (see Notice 82-9, 1982-1 C.B. 358); (2) Section 414(m) (concerning affiliated Service groups) (see Notices 82-7 and 82-8, 1982-1 C.B. 356, 357); (3) Section 414(n) (concerning employee leasing) (see Notice 84-11, 1984-2 C.B. 469); (4) Rev. Rul. 79-90, 1979-1 C.B. 155 (relating to actuarial assumptions); (5) Notice 81-2, 1981-1 C.B. 613 and Notice 81-10 1981-2 C.B. 543 (dealing with final regulations under section 415 of the Code); (6) Rev. Rul. 81-211, 1981-2 C.B. 98; (full vesting at normal retirement age rather than normal retirement date); (7) Notice 82-23, 1982-2 C.B. 752 (concerning final suspension of benefits regulations); (8) Rev. Rul. 84-45, 1984-1 C.B. 115 (regarding integration of offset plans); and (9) Treasury regulation 1.401-4(c)(7)(vi), T.D. 7934, 1984-1 C.B. 119, 120 (concerning final regulations on early termination of qualified plans). Such amendments must be effective as of the first day to which the respective qualification requirements apply to the plan.

As noted in Notice 82-19, 1982-2 C.B. 749, the revisions made to section 415 of the Code have an earlier effective date than other TEFRA changes, and amendments to comply with the TEFRA changes to section 415 may have been necessary at a date earlier than the date specified in section 1.401(b)-1 to prevent excess accruals. Any plan that used any of the simplified amendments relating to section 415, as set forth in Notice 83-4, must be amended to provide sufficient specificity in the plan to satisfy fully the definitely determinable requirement by the time it is required to be amended.

This notice applies both to individually designed plans and adopters of master or prototype plans. However, master or prototype plan adopters described in section 12 of Rev. Proc. 84-23, 1984-1 C.B. 47, will have until the later of the dates specified in the preceding paragraphs of this notice or section 12 of the revenue procedure to amend their plans to retroactively conform to the above requirements without loss of qualified status.

Inflation Adjustment for Computation of Windfall Profit Tax

Notice 85-15

Section 4989(b) of the Internal Revenue Code requires the determination of an inflation adjustment factor for use in computing the windfall profit tax.

The Service has determined that, for oil removed during the October-December quarter of 1985, the inflation adjustments are as follows:

Tier 1 or Tier 2 oil	0.4249
Tier 3 oil	0.6061

Worksheets for computation of the windfall profit tax are included in the Instructions for Form 6047, Windfall Profit Tax, and an explanation of the inflation adjustment may be found in the Specific Instructions for Line 4 of the worksheets.

List of Countries Requiring Cooperation With an International Boycott

Notice 85-16

In order to comply with the mandate of section 999(a)(3) of the Internal Revenue Code of 1954, the Department of the Treasury is publishing a current list of countries which may require participation in, or cooperation with, an international boycott [within the meaning of section 999(b)(3) of the Internal Revenue Code of 1954]. The list is the same as the prior quarterly list published in the Federal Register.

On the basis of the best information currently available to the Department of the Treasury, the following countries may require participation in, or cooperation with, an international boycott [within the meaning of section 999(b)(3) of the Internal Revenue Code of 1954].

Bahrain
Iraq
Jordan
Kuwait
Lebanon
Libya
Oman
Qatar
Saudi Arabi
Syria
United Arab Emirates
Yemen, Arab Republic
Yemen, Peoples
Democratic, Republic of

(Filed by the Office of the Federal Register on July 3, 1985, 8:45 a.m., and published in the issue of the Federal Register for July 5, 1985, 50 F.R. 27709)

List of Countries Requiring Cooperation With an International Boycott

Notice 85-17[1]

In order to comply with the mandate of section 999(a)(3) of the Internal Revenue Code of 1954, the Department of the Treasury is publishing a current list of countries which may require participation in, or cooperation with, an international boycott [within the meaning of section 999(b)(9) of the Internal Revenue Code of 1954]. The list is the

[1]Filed by the Office of the Federal Register on October 4, 1985, 8:45 a.m., and published in the issue of the Federal Register for October 7, 1985, 50 F.R. 40945.

same as the prior quarterly list published in the Federal Register.

On the basis of the best information currently available to the Department of the Treasury, the following countries may require participation in, or cooperation with, an international boycott [within the meaning of section 999(b)(3) of the Internal Revenue Code of 1954].

Bahrain
Iraq
Jordan
Kuwait
Lebanon
Libya
Oman
Qatar
Saudi Arabia
Syria
United Arab Emirates
Yemen, Arab Republic
Yemen, Peoples Democratic Republic of

RONALD A. PEARLMAN,
Assistant Secretary for Tax Policy.

Regulations Governing the Discipline of Appraisers Against Whom Aiding and Abetting Penalties Under the Internal Revenue Code Have Been Assessed

Notice 85-18

SUMMARY: This document contains the final regulations implementing section 156 of the Deficit Reduction Act of 1984, 98 Stat. 695 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1, 203]. Such legislation provides for the disqualification appraisals and appraisers' testimony in connection with Treasury Department or Internal Revenue Service proceedings with respect to any appraiser who has been assessed an aiding and abetting penalty under 26 U.S.C. 6701(a) after July 18, 1984.

DATE: These regulations are effective October 17, 1985. These regulations apply to any appraiser who has been assessed an aiding and abetting penalty under 26 U.S.C. 6701(a) after July 18, 1984.

FOR FURTHER INFORMATION CONTACT: Mr. Leslie S. Shapiro, Director of Practice, Internal Revenue Service, Washington, D.C. 20224, (202) 535-6787.

SUPPLEMENTARY INFORMATION:

On February 20, 1985, a notice of proposed rulemaking was published in the FEDERAL REGISTER (50 FR 7075) [Notice 85-7, 1985-1 C.B. 428] to amend the regulations in 31 CFR Part 10 by implementing section 156 of the Deficit Reduction Act of 1984, 58 Stat. 695. The notice proposed regulations providing for the disqualification of appraiser testimony and appraisals by an appraiser who has been assessed a penalty under 26 U.S.C. 6701(a) for aiding and abetting the understatement of tax. A 90-day period for comments was accorded the public. Five comments were received. They will be addressed below:

1. The commenter believes that there should be some sort of regulatory measures to standardize appraisal procedures. However, the commenter does not feel "such procedures" could be carried out effectively. (This reference presumedly is in reference to the regulation of appraisal services by the government.) Rather, a self-policing arrangement (within the profession) should be employed because of the many variables involved in appraising.

The comment deals with the regulation of appraisal services. We concur in the observation that appraisers may benefit from mechanisms established within the profession to assure professionally responsible appraisal services. However, the subject of the comment is outside the scope of section 156 of the Deficit Reduction Act of 1984. Therefore, it is not addressed in the proposed regulations and is not an appropriate subject for the final rule. This factor does not adversely affect any consideration being given the adoption of mechanisms within the profession to standardize appraisal procedures of those which may be forthcoming.

2. The comment supports the procedures set forth in the proposal. However, concern is expressed with respect to the need to establish standards applicable to real estate appraisals that could be used for guidance in Internal Revenue Service evaluations of real estate appraisals. The comment expresses the belief that a joint effort by the Internal Revenue Service and appraiser societies could develop standards that would be mutually useful.

The concept of establishing professional standards to the extent feasible is one which appears meritorious. However, it is one not directly related to the proposed regulations or to their statutory basis. Any implementation of the recommendation is a matter that should be addressed in a forum other than this rulemaking procedure.

3. The commenter expresses concern relative to a perceived inconsistency in the proposed regulations. The proposal provides that the appraisals of a person who has been disqualified will be preserved with respect to those (appraisals) provided before the date of disqualification. However, a similar provision is not made for the testimony of an appraiser regarding appraisals issued before the date of disqualification. The commenter believes such omission will work to the detriment of the taxpayers.

While the concern expressed in the comment is recognized, we do not concur in its theory. To permit an appraiser who is disqualified to continue appraisal service either in issuing appraisals or in providing testimony in connection with Treasury Department matters would be at variance with the statutory basis of the regulations and with the integrity of the discipline program. We believe it in fact is one of the very things the statute and regulations are designed to prohibit. An appraiser who is found to have engaged in conduct which has warranted the assessment of an aiding and abetting penalty has the potential of adversely affecting taxpayers responsibilities relative to our tax system, a potential the proposed regulations wishes to prevent.

However, we recognize that taxpayers may have placed good faith reliance on appraisals the disqualified appraiser issued prior to his/her disqualification. Consequently, the proposed regulations preserve the ability of taxpayers to present those appraisals for the purpose of demonstrating such good faith reliance. To enable a disqualified appraiser to provide testimony regarding such appraisals would not be directly related to the issue of good faith reliance.

4. The comment states, in effect, that section 156 of the Deficit Reduc-

tion Act of 1984 does not reflect its legislative history.

In this connection, it refers to the absence of clear guidelines as to (1) the definition of a "qualified appraiser" and (2) authority to disqualify appraisers who have engaged in misconduct in areas other than aiding and abetting the understatement of tax. The comment points out the dichotomy between these factors and the authorization given the Treasury Department with respect to others who perform professional services in connection with the Internal Revenue Service.

The comment appears to be directed at the limited nature of the legislation itself rather than at the proposed regulations. We find nothing in the comment indicating the proposal does not reflect the language of the statute or that the proposal contains provisions which should be modified in the final rule. Consequently, the comment does not affect this rulemaking procedure.

5. The comment expresses full support of the intent and purpose of the proposal. In order to eliminate any problems that cause violations of the regulations, it is suggested that an appraiser be a member in good standing of a national appraiser organization, be licensed by the government and that the appraisal fee for items to be used for a tax deduction not be based on a percentage of the appraised value. In addition, the commenter believes the appraiser who is subject to regulations by the Internal Revenue Service should be governed in the same manner as those who appear before the Internal Revenue Service, e.g. attorneys. Further, appraisers should be required to provide statements with their appraisals setting forth the bases for the appraisals.

The comment makes suggestions which are in the interests of the professional status of appraisers and the enhancement of the quality of appraisal services relative to Internal Revenue Service matters. However, the suggestions are outside the purview of the statutory amendment precipitating the proposed regulations and cannot be considered for inclusion in the final rule.

Because the proposed regulations are not affected by the comments received, the proposal as it appeared in the FEDERAL REGISTER is adopted by this Final Rule.

Special Analyses

This rule relates soley to professional services in connection with Internal Revenue Service and Treasury Department proceedings and is not expected to have any significant economic consequences.

Therefore, it has been determined that this rule is not a major rule as defined in Executive Order 12291 and a regulatory impact analysis is not required. It is hereby certified that this rule is not expected to have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required.

Drafting Information

The principal author of these regulations is Mr. Leslie S. Shapiro, Director of Practice, Department of the Treasury. Other present and former personnel in the Treasury Department participated in the development of the regulations, both as to substance and style.

List of Subjects in 31 CFR Part 10

Administrative rules and procedures, Lawyers, Accountants, Enrolled agents, Enrolled actuaries and appraisers.

Adoption of Amendments to the Regulations

Accordingly, 31 CFR Part 10 is amended by adopting, without change, the regulations proposed as a notice of proposed rulemaking in the FEDERAL REGISTER on February 20, 1985 (50 FR 7075) as follows:

Amendments to Regulations

PART 10—[AMENDED]

Accordingly, 31 CFR Part 10 is amended as follows:

1. The authority for Part 10 continues to read as follows:

AUTHORITY: Sec. 3, 23 Stat. 258, secs. 2-12, 60 Stat. 237 et seq.; 5 U.S.C. 301; 31 U.S.C. 330; 31 U.S.C. 321 (Reorg. Plan No. 26 of 1950, 15 FR 4935, 64 Stat. 1280 3 CFR 1949-53 Comp., p. 1017).

2. Subpart D, consisting of §10.90 through §10.93, is redesignated as Subpart E, consisting of §10.98 through §10.101.

3. A new Subpart D is added, to read as follows:

Subpart D—Rules Applicable to Disqualification of Appraisers

Sec.

10.77 Authority to disqualify; effect of disqualification.
10.78 Institution of proceeding.
10.79 Contents of complaint.
10.80 Service of complaint and other papers.
10.81 Answer.
10.82 Supplemental charges.
10.83 Reply to answer.
10.84 Proof, variance, amendment of pleadings.
10.85 Motions and requests.
10.86 Representation.
10.87 Administrative Law Judge.
10.88 Hearings.
10.89 Evidence.
10.90 Depositions.
10.91 Transcript.
10.92 Proposed findings and conclusions.
10.93 Decision of the Administrative Law Judge.
10.94 Appeal to the Secretary.
10.95 Decision of the Secretary.
10.96 Final Order.
10.97 Petition for reinstatement.

Subpart D—Rules Applicable to Disqualification of Appraisers

§10.77 Authority to disqualify; effect of disqualification.

(a) *Authority to disqualify.* Pursuant to section 156 of the Deficit Reduction Act of 1984, 98 Stat. 695, amending 31 U.S.C. 330, the Secretary of the Treasury, after due notice and opportunity for hearing may disqualify any appraiser with respect to whom a penalty has been assessed after July 18, 1984, under section 6701(a) of the Internal Revenue Code of 1954, as amended (26 U.S.C. 6701(a)).

(b) *Effect of disqualification.* If any appraiser is disqualified pursuant to 31 U.S.C. 330 and this Subpart:

(1) Appraisals by such appraiser shall not have any probative effect in any administrative proceeding before the Department of the Treasury or the Internal Revenue Service; and

(2) Such appraiser shall be barred from presenting evidence or testimony in any such administrative proceeding. Paragraph (b)(1) shall apply to appraisals made by such appraiser after the effective date of disqualification, but

shall not apply to appraisals made by the appraiser on or before such date. Notwithstanding the forgoing sentence, an appraisal otherwise barred from admission into evidence pursuant to paragraph (b)(1) may be admitted into evidence solely for the purpose of determining the taxpayer's reliance in good faith on such appraisal. Paragraph (b)(2) shall apply to the presentation of testimony or evidence in any administrative proceeding after the date of such disqualification, regardless of whether such testimony or evidence would pertain to an appraisal made prior to such date.

§10.78 Institution of proceeding.

(a) *In general.* Whenever the Director of Practice is advised or becomes aware that a penalty has been assessed against an appraiser under 26 U.S.C. 6701(a), he/she may reprimand such person or institute a proceeding for disqualification of such appraiser through the filing of a complaint. Irrespective of whether a proceeding for disqualification has been instituted against an appraiser, the Director of Practice may confer with an appraiser against whom such a penalty has been assessed concerning such penalty.

(b) *Voluntary disqualification.* In order to avoid the initiation or conclusion of a disqualification proceeding, an appraiser may offer his/her consent to disqualification. The Director of Practice, in his/her discretion, may disqualify an appraiser in accordance with the consent offered.

§10.79 Contents of complaint.

(a) *Charges.* A proceeding for disqualification of an appraiser shall be instituted through the filing of a complaint, which shall give a plain and concise description of the allegations that constitute the basis for the proceeding. A complaint shall be deemed sufficient if it refers to the penalty previously imposed on the respondent under section 6701(a) of the Internal Revenue Code of 1954, as amended (26 U.S.C. 6701(a)), and advises him/her of the institution of the proceeding.

(b) *Demand for answer.* In the complaint, or in a separate paper attached to the complaint, notification shall be given of the place and time within which the respondent shall file his/her answer, which time shall not be less than 15 days from the date of service of the complaint, and notice shall be given that a decision by default may be rendered against the respondent in the event there is failure to file an answer.

§10.80 Service of complaint and other papers.

(a) *Complaint.* The complaint or a copy thereof may be served upon the respondent by certified mail, or first-class mail as hereinafter provided, by delivering it to the respondent or his/her attorney or agent of record either in person or by leaving it at the office or place of business of the respondent, attorney or agent, or in any other manner that has been agreed to by the respondent. Where the service is by certified mail, the return post office receipt duly signed by or on behalf of the respondent shall be proof of service. If the certified mail is not claimed or accepted by the respondent and is returned undelivered, complete service may be made by mailing the complaint to the respondent by first-class mail, addressed to the respondent at the last address known to the Director of Practice. If service is made upon the respondent in person or by leaving the complaint at the office or place of business of the respondent, the verified return by the person making service, setting forth the manner of service, shall be proof of such service.

(b) *Service of papers other than complaint.* any paper other than the complaint may be served as provided in paragraph (a) of this section or by mailing the paper by first-class mail to the respondent at the last address known to the Director of Practice, or by mailing the paper by first-class mail to the respondent's attorney or agent of record. Such mailing shall constitute complete service. Notices may be served upon the respondent or his/her attorney or agent of record by telegraph.

(c) *Filing of papers.* Whenever the filing of a paper is required or permitted in connection with a disqualification proceeding under this Subpart or by rule or order of the Administrative Law Judge, the paper shall be filed with the Director of Practice, Treasury Department, Internal Revenue Service, Washington, D.C. 20224. All papers shall be filed in duplicate.

§10.81 Answer.

(a) *Filing.* The respondent's answer shall be filed in writing within the time specified in the compliant or notice of institution of the proceeding, unless on application the time is extended by the Director of Practice or the Administrative Law Judge. The answer shall be filed in duplicate with the Director of Practice.

(b) *Contents.* The answer shall contain a statement of facts that constitute the grounds of defense, and it shall specifically admit or deny each allegation set forth in the complaint, except that the respondent shall not deny a material allegation in the complaint that he/she knows to be true, or state that he/she is without sufficient information to form a belief when in fact he/she possesses such information.

(c) *Failure to deny or answer allegations in the complaint.* Every allegation in the complaint which is not denied in the answer shall be deemed to be admitted and may be considered as proved, and no further evidence in respect of such allegation need be adduced at a hearing. Failure to file an answer within the time prescribed in the notice to the respondent, except as the time for answer is extended by the Director of Practice or the Administrative Law Judge, shall constitute an admission of the allegations of the complaint and a waiver of hearing, and the Administrative Law Judge may make his/her decision by default without a hearing or further procedure.

§10.82 Supplemental charges.

If it appears that the respondent in his/her answer, falsely and in bad faith, denies a material allegation of fact in the complaint or states that the respondent has no knowledge sufficient to form a belief, when he/she in fact possesses such information, or if it appears that the respondent has knowingly introduced false testimony during proceedings for his/her disqualification, the Director of Practice may thereupon file supplemental charges against the respondent. Such supplemental charges may be tried with other charges in the case, provided the respondent is given due notice thereof and is afforded an opportunity to prepare a defense thereto.

§10.83 Reply to answer.

No reply to the respondent's answer

shall be required, and any new matter in the answer shall be deemed to be denied, but the Director of Practice may file a reply in his/her discretion or at the request of the Administrative Law Judge.

§10.84 Proof, variance, amendment of pleadings.

In the case of a variance between the allegations in a pleading and the evidence adduced in support of the pleading, the Administrative Law Judge may order or authorize amendment of the pleading to conform to the evidence; provided, that the party who would otherwise be prejudiced by the amendment is given reasonable opportunity to meet the allegations of the pleading as amended, and the Administrative Law Judge shall make findings on any issue presented by the pleadings as so amended.

§10.85 Motions and requests.

Motions and requests may be filed with the Director of Practice or with the Administrative Law Judge.

§10.86 Representation.

A respondent may appear in person or may be represented by counsel or other representative. The Director of Practice may be represented by an attorney or other employee of the Department of the Treasury.

§10.87 Administrative Law Judge.

(a) *Appointment.* An Administrative Law Judge appointed as provided by 5 U.S.C. 3105, shall conduct proceedings upon complaints for the disqualification of appraisers.

(b) Powers of Administrative Law Judge. Among other powers, the Administrative Law Judge shall have authority, in connection with any disqualification proceeding assigned or referred to him/her to do the following:

(1) Administer oaths and affirmations;

(2) Make rulings upon motions and requests which rulings may not be appealed from prior to the close of a hearing except at the discretion of the Administrative Law Judge, in extraordinary circumstances;

(3) Determine the time and place of hearing and regulate its course and conduct;

(4) Adopt rules of procedure and modify the same from time to time as occasion requires for the orderly disposition of proceedings;

(5) Rule upon offers of proof, receive relevant evidence, and examine witnesses;

(6) Take or authorize the taking of depositions;

(7) Receive and consider oral or written argument on facts or law;

(8) Hold or provide for the holding of conferences for the settlement or simplification of the issues by consent of the parties;

(9) Perform such acts and take such measures as are necessary or appropriate to the efficient conduct of any proceeding; and

(10) Make initial decisions.

§10.88 Hearings.

(a) *In general.* The Administrative Law Judge shall preside at the hearing on a complaint for the disqualification of an appraiser. Hearings shall be stenographically recorded and transcribed and the testimony of witnesses shall be taken under oath or affirmation. Hearings will be conducted pursuant to 5 U.S.C. 556.

(b) *Failure to appear.* If either party to the proceeding fails to appear at the hearing after due notice thereof has been sent to him/her, the right to a hearing shall be deemed to have been waived and the administrative Law Judge may make a decision by default against the absent party.

§10.89 Evidence.

(a) *In general.* The rules of evidence prevailing in courts of law and equity are not controlling in hearings on complaints for the disqualification of appraisers. However, the Administrative Law Judge shall exclude evidence which is irrelevant, immaterial, or unduly repetitious.

(b) *Depositions.* The deposition of any witness taken pursuant to 10.90 may be admitted.

(c) *Proof of documents.* Official documents, records, and papers of the Internal Revenue Service of the Department of the Treasury shall be admissible in evidence without the production of an officer or employee to authenticate them. Any such documents, records,and papers may be evidenced by a copy attested or identified by an officer or employee of the Internal Revenue Service or the Department of the Treasury, as the case may be.

(d) *Exhibits.* If any document, record, or other paper is introduced in evidence as an exhibit, the Administrative Law Judge may authorize the withdrawal of the exhibit subject to any conditions which he/she deems proper.

(e) *Objections.* Objections to evidence shall be in short form, stating the grounds of objection relied upon, and the record shall not include argument thereon, except as ordered by the Administrative Law Judge. Rulings on such objections shall be a part of the record. No exception to the ruling is necessary to preserve the rights of the parties.

§10.90 Depositions.

Depositions for use at a hearing may, with the written approval of the Administrative Law Judge, be taken either by the Director of Practice or the respondent or their duly authorized representatives. Depositions may be taken upon oral or written interrogatories, upon not less than 10 days' written notice to the other party before any officer duly authorized to administer an oath for general purposes or before an officer or employee of the Internal Revenue Service who is authorized to adminsiter an oath in internal revenue matters. Such notice shall state the names of the witnesses and the time and place where the depositions are to be taken. The requirement of 10 days' notice may be waived by the parties in writing, and depositions may then be taken from the persons and at the times and places mutually agreed to by the parties. When a deposition is taken upon written interrogatories, any cross-examination shall be upon written interrogatories. Copies of such written interrogatories shall be served upon the other party with the notice, and copies of any written cross-interrogation shall be mailed or delivered to the opposing party at least 5 days before the date of taking the depositions, unless the parties mutually agree otherwise. A party upon whose behalf a deposition is taken must file it with the Administrative Law Judge and serve one copy upon the opposing party. Expenses in the reporting of depositions shall be borne by the party at whose instance the deposition is taken.

§10.91 Transcript.

In cases where the hearing is steno-

graphically reported by a Government contract reporter, copies of the transcript may be obtained from the reporter at rates not to exceed the maximum rates fixed by contract between the Government and the reporter. Where a hearing is stenographically reported by a regular employee of the Internal Revenue Service, a copy thereof will be supplied to the respondent either without charge or upon the payment of a reasonable fee. Copies of exhibits introduced at the hearing or at the taking of depositions will be supplied to the parties upon the payment of a reasonable fee (Sec. 501, Pub. L. 82-137, 65 Stat. 290 (31 U.S.C. 483a)).

§10.92 Proposed findings and conclusions.

Except in cases where the respondent has failed to answer the complaint or where a party has failed to appear at the hearing, the Administrative Law Judge, prior to making a decision, shall afford the parties a reasonable opportunity to submit proposed findings and conclusions and supporting reasons therefor.

§10.93 Decision of the Administrative Law Judge.

As soon as practicable after the conclusion of a hearing and the receipt of any proposed findings and conclusions timely submitted by the parties, the Administrative Law Judge shall make the initial decision in the case. The decision shall include (a) a statement of findings and conclusions, as well as the reasons or basis therefor, upon all the material issues of fact, law, or discretion presented on the record, and (b) an order of disqualification or an order of dismissal of the complaint. The Administrative Law Judge shall file the decision with the Director of Practice and shall transmit a copy thereof to the respondent of his attorney of record. In the absence of an appeal to the Secretary of the Treasury, or review of the decision upon motion of the Secretary, the decision of the Administrative Law Judge shall without further proceedings become the decision of the Secretary of the Treasury 30 days from the date of the Administrative Law Judge's decision.

§10.94 Appeal to the Secretary.

Within 30 days from the date of the Administrative Law Judge's decision, either party may appeal such decision to the Secretary of the Treasury. If an appeal is by the respondent, the appeal shall be filed with the Director of Practice in duplicate and shall include exceptions to the decision of the Administrative Law Judge and supporting reasons for such exceptions. If an appeal is filed by the Director of Practice, a copy thereof shall be transmitted to the respondent. Within 30 days after receipt of an appeal or copy thereof, the other party may file a reply brief in duplicate with the Director of Practice. If the reply brief is filed by the Director, a copy shall be transmitted to the respondent. Upon the filing of an appeal and a reply brief, if any, the Director of Practice shall transmit the entire record to the Secretary of the Treasury.

§10.95 Decision of the Secretary.

On appeal from or review of the initial decision of the Administrative Law Judge, the Secretary of the Treasury shall make the agency decision. In making such decision, the Secretary of the Treasury will review the record or such portions thereof as may be cited by the parties. A copy of the Secretary's decision shall be transmitted to the respondent by the Director of Practice.

§10.96 Final order.

Upon the issuance of a final order disqualifying an appraiser, the Director of Practice shall give notice thereof to appropriate officers and employees of the Internal Revenue Service and to interested departments and agencies of the Federal Government.

§10.97 Petition for reinstatement.

The director of Practice may entertain a petition for reinstatement from any disqualified appraiser after the expiration of 5 years following such disqualification. Reinstatement may not be granted unless the Director of Practice is satisfied that the petitioner, thereafter, is not likely to conduct himself/herself contrary to 26 U.S.C. 6701(a), and that granting such reinstatement would not be contrary to the public interest.

4. The newly designated §10.98 is amended by revising paragraph (a) to read as follows:

§10.98 Records.

(a) *Availability*. There are made available to public inspection at the Office of Director of Practice the roster of all persons enrolled to practice, the roster of all persons disbarred or suspended from practice, and the roster of all disqualified appraisers. Other records may be disclosed upon specific request, in accordance with the disclosure regulations of the Internal Revenue Service and the Treasury Department.

* * * * *

5. The newly designated §10.99 is revised to read as follows:

§10.99 Effective date of regulations.

The regulations of this Part are effective on October 17, 1985 and shall supersede all prior regulations related to this part.

6. The newly designated §10.100 is revised to read as follows:

§10.100 Saving clause.

Any proceeding for the disbarment or suspension of an attorney, certified public accountant, or enrolled agent, instituted but not closed prior to the effective date of these revised regulations, shall not be affected by such regulations. Any proceeding under this Part based on conduct engaged in prior to the effective date of these regulations may be instituted subsequent to such effective date.

Dated: September 23, 1985.

ROBERT M. KIMMITT,
General Counsel.

(Filed by the Office of the Federal Register on October 16, 1985, 8:45 a.m., and published in the issue of the Federal Register for October 17, 1985, 50 F.R. 42014)

Inflation Adjustment for Computation of Windfall Profit Tax

Notice 85-19

Section 4989(b) of the Internal Revenue Code requires the determination of an inflation adjustment factor for use in computing the windfall profit tax.

The Service has determined that, for oil removed during the January-March quarter of 1986, the inflation adjustments are as follows:

Tier 1 or Tier 2 oil	0.4326
Tier 3 oil	0.6228

Worksheets for computation of the

windfall profit tax are included in the Instructions for Form 6047, Windfall Profit Tax, and an explanation of the inflation adjustment may be found in the Specific Instructions for Line 4 of the worksheets.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 85-32

SECTION 1. PURPOSE

The purpose of this revenue procedure is to modify the list of exempt organization key Districts contained in Section 4 of Rev. Proc. 84-46, 1984-1 C.B. 541.

SEC. 2. BACKGROUND

In a move to improve service to taxpayers and to equalize workload among regions, the Internal Revenue Service has realigned some of its offices.

SEC. 3. DISTRICT REALIGNMENT

.01 The 10 key district offices that process applications for recognition of exemption, the Internal Revenue Districts covered by each, and the regional office designations are as follows:

Key District(s)	IRS Districts Covered
	CENTRAL REGION
Cincinnati	Cincinnati, Cleveland, Detroit, Indianapolis, Louisville, and Parkersburg
	MID-ATLANTIC REGION
Baltimore	Baltimore (which includes the District of Columbia and Office of International Operations); Pittsburgh, and Richmond
Newark	Newark, Philadelphia, and Wilmington
	MIDWEST REGION
Chicago	Aberdeen, Chicago, Des Moines, Fargo, Helena, Milwaukee, Omaha, St. Louis, St. Paul, and Springfield
	NORTH-ATLANTIC REGION
Atlanta	Atlanta, Birmingham, Columbia, Greensboro, Jackson, Jacksonville, Little Rock, New Orleans, and Nashville
	SOUTHWEST REGION
Dallas	Albuquerque, Austin, Cheyenne, Dallas, Denver, Houston, Oklahoma City, Phoenix, Salt Lake City, and Wichita
	WESTERN REGION
Los Angeles	Honolulu, Laguna Niguel, and Los Angeles
San Francisco	Reno, Sacramento, San Jose, and San Francisco
Seattle	Anchorage, Boise, Portland, and Seattle

.02 This list replaces the list found in Section 4 of Rev. Proc. 84-46.

SEC. 4. EFFECT ON OTHER DOCUMENTS

Section 4 of Rev. Proc. 84-46 is modified.

SEC. 5. EFFECTIVE DATE

This revenue procedure is effective July 1, 1985, the date of its publication in the Internal Revenue Bulletin.

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26 CFR 601.702: Publication and public inspection.
(Also Part 1, Section 6103.)

Rev. Proc. 85-33

SECTION 1. PURPOSE

.01. The purpose of this revenue procedure is to provide instructions to federal and state agencies requesting taxpayer address information and to federal agencies requesting tax delinquent account status indicators from the Internal Revenue Service.

.02 These instructions relate to large volume requests of 100 or more items. Information on procedures regarding small volume requests can be obtained by contacting the local Internal Revenue Service district office.

SEC. 2. AUTHORITY

.01 Taxpayer address information can be obtained by an agency under the authority of section 6103(d), (m)(2), (m)(3), and (m)(4) of the Internal Revenue Code.

.02 Section 6103(d) of the Code provides for the disclosure of return information (including address information) to State tax agencies for State tax administration purposes.

.03 Section 6103(m)(2) of the Code provides for the disclosure of address information to federal agencies for their use in collecting federal claims against an individual in accordance with sections 3711, 3717, and 3718 of Title 31 of the United States Code. This section also provides for the redisclosure of a taxpayer's mailing address to a consumer reporting agency, but only to allow for the preparation of a commercial credit report on the taxpayer for use by the requesting federal agency in accordance with the Federal Claims Collection Act of 1966, as amended by the Debt Collection Act of 1982 and codified in sections 3711, et. seq..

.04 Section 6103(m)(3) of the Code allows for the disclosure of a taxpayer's mailing address to the National Institute for Occupational Health Safety and (NIOSH) soley for locating indi-

viduals who are or may have been exposed to occupational hazards to determine the status of their health or to inform them of the possible need for medical care and treatment.

.05 Section 6103(m)(4) of the Code allows for the disclosure of address information to the Secretary of Education for purposes of collecting defaulted student loans made from the fund established under Part B or E, Title IV, Higher Education Act of 1965 or made under section 3(a)(1) of the Migration and Refugee Assistance Act of 1962 to a student of an institution of higher education.

.06 Section 6103(1)(3) of the Code authorizes the Service to disclose a Tax Delinquent Account Status Indicator to federal agencies administering any included federal loan program. For purposes of this paragraph, the term "included federal loan program" means any program under which the United States or a federal agency makes, guarantees, or insures loans, and with respect to which there is in effect a determination by the Director of the Office of Management and Budget (which has been published in the Federal Register) that the application of this paragraph to such program will substantially prevent or reduce future delinquencies under such program. A listing of included Federal loan programs was published in the Federal Register dated December 27, 1982, 47 F.R. 57595.

SEC. 3. BACKGROUND

.01 The information provided will be extracted monthly from the Internal Revenue Service Individual Master File (IMF) and Business Master File (BMF) located at the Internal Revenue Service National Computer Center (NCC) in Martinsburg, West Virginia. The IMF contains tax accounts of individuals. The BMF contains tax accounts of business entities (i.e., corporations, sub-chapter S corporations, partnerships, exempt organizations and estates.)

.02 IMF Address Requests may be made on magnetic tape or computer punch cards.

.03 Tax Delinquent Account Status Indicator Requests and BMF Address Requests must be made on magnetic tape.

.04 The Taxpayer Identification Number (TIN) provides an indication whether the taxpayer's account would be found on the IMF or BMF. Accounts are established on the IMF under Social Security Numbers (SSN, format xxx-xx-xxxx). Accounts are established on the BMF under Employer Identification Numbers (EIN, format xx-xxxxxxx), except for estates, which appear on the BMF with an SSN.

.05 Data will be extracted from the IMF and BMF based on the existence of a match between the master file and the data record submitted by the requester. Both the Taxpayer Identification Number (TIN) and name control on the data record request must match with a record on the Master File before any data is extracted. Without a match, the Service will not be able to provide the requested data. See Section 15 for instructions for determining Name Control.

.06 If unsure as to whether an account would appear on the IMF or BMF it may be expedient to request information from both the IMF and the BMF.

.07 Accounts for married individuals are sometimes established on the IMF using the SSN of one of the individuals as the control or primary SSN. Submissions for IMF extracts will first be run against the Internal Revenue Service Spouse-Primary SSN Record File to determine the primary SSN. Although the primary SSN identified will be used in the IMF extract process, the SSN shown on the output tape will be that provided by the requesting agency.

SEC. 4. APPLICATION FOR INCLUSION IN PROGRAM

.01 Federal agencies wishing to receive data under sections 6103(1)(3) or (m)(2) for debt collection purposes should submit their applications to:

Internal Revenue Service
1111 Constitution Ave., N.W.
Director, Disclosure and
Security Division, PM:S:DS
Washington, D.C. 20224

The application should indicate whether the agency wishes to enter into an agreement to receive address data, TDA data or both. The application should also indicate whether data will be requested from the IMF, BMF, or both, and whether the request submissions will be made via tapes or punch cards.

.02 Federal or state agencies wishing to receive data under sections other than 6103(1)(3) or (m)(2) should also submit their application to the above address. The application should indicate whether data will be requested from the IMF, BMF, or both, and whether the request submissions will be made via magnetic tape or punch cards.

.03 A request under section 6103(m)(2) of the Code must meet the following criteria:

(i) It must be in writing and be signed by the head of the agency or a designee. "Head of agency" means the head of an executive or legislative department, agency, or instrumentality;

(ii) If the request is signed by a designee, it must state that the authority to collect or compromise a federal claim under sections 3711, 3717, and 3718 of Title 31 of the U.S. Code has been delegated to that individual, and a copy of the delegation order must be submitted with the initial request:

(iii) It must indicate that it involves a claim for money or property arising out of the activities of, or referred to, the requesting agency;

(iv) It must state that the information will be used by proper agency officers, employees, or agents in locating the taxpayer to collect or compromise a federal claim against the taxpayer in accordance with sections 3711, 3717, and 3718 of Title 31 of the U.S. Code.

.04 A request under Section 6103(m)(3) of the Code must meet the following conditions:

(i) It must be in writing and be signed by the responsible NIOSH official;

(ii) It must state that the addresses will be used by officers and employees of NIOSH solely for locating individuals who are or may have been exposed to occupational hazards in order to determine the status or their health or to inform them of the possible need for medical treatment, and;

(iii) It must state that the addresses will be disclosed to third parties only for locating such individuals to determine the status of their health, or to advise them of the possible need for medical care.

.05 A request under section

6103(m)(4) of the Code must meet the following conditions:

(i) It must be in writing and be signed by the Secretary of Education and must specify that section 6103(m)(4) is the statutory authority for the request;

(ii) It must specify that the persons whose addresses are requested are in default on loans made under Part B or E of Title IV of the Higher Education Act of 1965 or under section 3(a)(1) of the Migration and Refugee Act of 1962, and;

(iii) It must state that the address information will be disclosed solely to persons authorized by section 6103(m)(4) to receive it and solely for the purposes in section 6103(m)(4).

.06 A request under section 6103(1)(3) of the code must meet the following conditions:

(i) It must be made in writing and be signed by an officer or employee of the agency administering an included Federal loan program;

(ii) It must state the statutory authority for the disclosure, i.e. section 6103(1)(3);

(iii) It must briefly explain the purpose for which the information is sought and state the intended use of the information.

.07 A request under section 6103(d) of the code must meet the following conditions:

(i) It must be made in writing and be signed by the head of the state tax agency;

(ii) It must contain the name, title and office location of the state tax agency representative who is to inspect or receive the address information on behalf of the agency;

(iii) It must state the specific state tax law which the agency is charged with administering;

(iv) It must state the agency's specific tax administration need for the information and an explanation of how such information will be used to satisfy that need, and;

(v) It must contain an agreement to all of the safeguard requirements imposed by section 6103(p)(4) of the Code and any additional safeguard requirements imposed by the Service.

.08 Upon receipt and approval of an application from an agency, the Service will prepare Form 5181, Agreement Covering Reimbursable Services (see Exhibit A). The requesting agency will be provided with the prepared agreement.

.09 The requesting agency will complete boxes 5a, b, and c and 9a, b, and c of Form 5181. The person indicated in box 5a will be the person coordinating requests and receipt of data from the Service. The signature in box 9a must be of an authorized agency head or other delegated official.

.10 The original of the signed agreement should be returned to the Service at the address indicated in 01. above.

.11 The Service will receive the signed agreement from agencies. After signature of the Service's approving official is obtained, a copy of the agreement will be returned to the requesting agency. Upon receipt of the signed agreement, the agency may begin making submissions for the type of data specified in the agreement.

.12 Each approved agreement returned to a requesting agency will provide an "Agency Code(s)" to be used in all data requests. Distinct agency codes will be provided for each type of request.

SEC. 5. LIMITATIONS AND SAFEGUARDS

.01 Officers and employees who are entitled to access to this information must not redisclose the information except as authorized by section 6103 of the Code.

.02 Officers and employees of federal and state agencies who disclose return information in a manner or for a purpose not authorized by section 6103 of the Code are subject to the criminal penalty provisions of section 7213. Federal agencies and officers and employees of state agencies who disclose return information in a manner or for a purpose not authorized by section 6103 are also subject to the civil damages provisions of section 7431.

.03 Any unauthorized disclosure of return information must be reported to the nearest Internal Revenue Service Regional Inspector. The name, address, and telephone number of this individual may be obtained from the disclosure officer at the Internal Revenue Service district in which the agency is located.

.04 Return information which is obtained pursuant to section 6103(d) and (1)(3) is subject to the safeguarding, recordkeeping, and reporting requirements of section 6103(p)(4) of the Code. If return information is obtained pursuant to section 6103(m)(2) or (m)(4) and is subsequently redisclosed to an agent, then both the federal agency receiving the information from the Service and the agent are subject to the safeguard provisions of section 6103(p)(4).

.05 If the return information becomes a part of the agency case file regarding a specific taxpayer, the case file must be segregated to the maximum extent possible and safeguarded under the terms and conditions of section 6103(p)(4). Destruction of return information is also governed by section 6103(p)(4).

.06 An agency subject to section 6103(p)(4) must submit a safeguard procedures report within 30 days of initial receipt of the return information. The report will detail the security accorded the information, the individuals who may request and have access to the information, the flow of the information once the agency has received it, as well as other information which will give a comprehensive picture of the need for, the use of, and the disposal of, the return information. Publication 1075 gives additional information about the safeguard procedures report, including the address where the safeguard procedures report must be sent, and may be obtained from the Internal Revenue Service district disclosure officer in the district in which the agency is located.

.07 The agency must also submit an annual safeguard activity report giving current information on its safeguard program. The information required for this report is also detailed in Publication 1075.

SEC. 6. PUNCH CARD SUBMISSIONS

.01 Ship punch card input (prepaid) to the Service Center assigned at the time of initial contracting. The following is a list of Service Centers and their addresses:

Andover Service Center
Director
Andover Service Center
310 Lowell Street
Andover, MA 01812

Atlanta Service Center
Director
Atlanta Service Center
4800 Buford Highway
Chamblee, GA 30006

Austin Service Center
Director
Austin Service Center
3651 South Interregional Highway
Austin, TX 78740

Brookhaven Service Center
Director
Brookhaven Service Center
1040 Waverly Avenue
Holtsville, NY 11799

Cincinnati Service Center
Director
Cincinnati Service Center
201 West Second Street
Covington, KY 41019

Fresno Service Center
Director
Fresno Service Center
5045 East Butler Avenue
Fresno, CA 93888

Kansas City Service Center
Director
Kansas City Service Center
2306 East Bannister Road
Kansas City, MO 64170

Memphis Service Center
Director
Memphis Service Center
3131 Democrat Road
Memphis, TN 38110

Ogden Service Center
Director
Ogden Service Center
1160 West 1200 South Street
Ogden, UT 84201

Philadelphia Service Center
Director
Philadelphia Service Center
11601 Roosevelt Boulevard
Philadelphia, PA 19155

.02 Punch card input will be converted to tape at the Service Centers and shipped to NCC for matching.

.03 Prior to tape conversion, validity checks will be performed on punch cards at the Service Center. Cards containing errors (e.g., an alphabetic character in the Social Security Number, a Social Security Number outside the range of numbers assigned for use by the Social Security Administration, etc.) will be screened out and returned to the customer. These cards will not be converted to tape for matching.

.04 Include a transmittal letter with each shipment. The transmittal should identify the punch cards as input to the Internal Revenue Service Taxpayer Address Request Program, indicate the number of cards submitted and the return address. The transmittal should also include the name and telephone number of an individual within the agency who can aid in reconciling shipping problems.

.05 After the NCC matching extract, output will be returned to the Service Centers for creation of Forms 4453, Taxpayer Address. Service Centers will ship Forms 4453 back to the requesting agency prepaid. Unless otherwise requested by the customer, punch card input will be destroyed upon shipment of Forms 4453.

SEC. 7. PUNCH CARD INPUT SPECIFICATIONS (IMF ADDRESS REQUESTS ONLY)

.01 Punch Card Input Format

Card Columns	*Contents*
1–3	*Agency Code*. Enter the three digit number assigned at the time of initial negotiation. Use only the agency code assigned for IMF punch card address requests.
4–12	*Social Security Number*. Enter the nine digit Social Security Number which will be used for matching with the IMF.
13–15	*Project Code*. Enter the constant "719" which identifies this as an IMF Address Request.
16–41	*Agency Case Control Number*. This field is provided for the use of the customer and may contain any alphabetic or numeric data needed for control purposes, or may be used as a reference field, at the discretion of the customer. Output data will be sorted in alpha-numeric sequence by the first nine positions of this field. Leave positions 16–24 blank if you desire your output in sequence by SSN.
42–45	*Name Control*. Enter the four character Name Control which will be used for matching with the IMF.
46–51	*Blanks*. Leave these positions blank.
52–80	*Optional Use*. The customer may use this field for a particular need. The data will not be printed on the output.

SEC. 8 PUNCH CARD OUTPUT SPECIFICATIONS, FORM 4453.

.01 If there is a match on both Social Security Number and Name Control, Form 4453 will be printed, formatted as in Exhibit B. The data elements are:

Element	*Contents*
1	*Name and Address.* The name provided is that which was entered by the tax payer on the most recent tax return. A second name line may be present showing a continuation of the first name line (i.e., "in care of Joe Doe", "John Doe, Executor," etc.) The address will show the latest street address, Post Office Box number, or other address, city, state and Zip Code furnished by the taxpayer on a tax return or a notice of change of address provided to the Service by the taxpayer. Zeros in all five positions of the Zip Code indicate that the taxpayer did not provide a valid Zip Code and the city of town could not be located in the Zip Code Master File maintained by the Service. Zeros in the last two positions indicate that only the area code (the first three digits) could be determined.
2	*Social Security Number.* As input.
3	*Agency Code.* As input.
4	*Agency Case Control Number.* As input.
5	*Name Control.* As input.
6	*Last Filing Date.* The year of latest activity on the taxpayer's account. This information is provided to State agencies only. It is not provided to Federal agencies.
7	*0 or 1.* Service use only.

.02 If there is no match between the input Social Security Number and/or Name control and the Individual Master File, Form 4453 will be printed, formatted as in Exhibit C. The data elements are:

Element	*Contents*
1	*Name and Address.* If the input Social Security Number (or SSN extracted from Spouse-Primary SSN Record File) does not match an SSN on the Individual Master File, ***NO RECORD SSN*** will be printed in this area. If the input Name Control does not match the Name Control for that record on the Master File, ***NO RECORD NC*** will be printed in this area.
2	*Social Security Number.* As input.
3	*Agency Code.* As input.
4	*Agency Case Control Number.* As input.

SEC. 9 TAPE SUBMISSIONS

.01 Tape submissions must be in the format specified for that type of request.

.02 Separate tapes must be submitted for address requests and TDA requests. Separate tapes must also be submitted for IMF and BMF requests. A separate tape, therefore, is required for each of the following type requests.

a) IMF Address Requests
b) IMF TDA Requests
c) BMF Address Requests
d) BMF TDA Requests

.03 An agency may submit any combination of types of requests in a given month, or even make no tape submission in a given month. They should not, however, combine more than one type of request on a signal reel of tape. There is no limitation on the number of reels of tape that may be submitted in a month for particular type of request.

.04 A file is defined as one or more reels of a specific type of request, submitted at one time.

.05 It is the responsibility of the requesting agency to assure that input record data meet all specifications. Data Records containing invalid characters in the Taxpayer Identification Number field or in the Agency Code field will be dropped from processing. Duplicate requests by the same agency will also be dropped.

SEC. 10. SHIPMENT OF TAPES

.01 Ship input tapes (prepaid) to:

Internal Revenue Service
National Computer Center
Martinsburg, WV 25401
Attn: Chief Librarian

.02 Each input tape reel should contain the following information on its label:

a) Agency Name
b) Tape Reel Identification Number
c) An indication of "Request for Taxpayer Address Data or TDA Data."
d) Assigned Agency Code Number for type of request.
e) IMF or BMF extract

.03 For each shipment, a transmittal letter should be sent under separate cover to the National Computer Center. The transmittal should indicate the number of reels in the shipment, the reel identification number of each reel, the number of records on each reel, the assigned agency code for each reel, and the type of request (BMF TDA, IMF Address, etc.). The transmittal should also include the name and telephone number of an individual within the agency who can aid in reconciling shipping problems.

.04 Address the transmittal to:

Internal Revenue Service
National Computer Center
P.O. Box 1208
Martinsburg, WV 25401

.05 Please provide magnetic tapes (at least three tapes) for your output, when making initial input shipment. The input tape is scheduled for a 100 day retention. After that time, the input tape will be scratched and the tape used for your next output.

.06 If Internal Revenue Service tapes must be used to provide output,new tapes will be used. The cost of these tapes will be reflected in the agency billing.

SEC. 11. INPUT TAPE SPECIFICATIONS

.01 All input tape should be submitted with the following characteristics:

a) 9 track
b) 1600 BPI
c) Extended binary coded decimal (EBCDIC)
d) Odd Parity

.02 Each tape reel must contain the following types of records.

Header Record
Tape Mark (after the Header Record)
Data Records—Maximum of 100 data records per block. Separate blocks from each other by an inter-record gap. Each tape reel can consist of several sets of data blocks.
Tape Mark after the last Data Record on a Tape.
Trailer Record
Tape Mark

.03 BMF TDA Requests
(a) *Header Record*

Position(s)	*Contents*
1–4	*Header Label I.D.* Enter the constant "1HDR" to identify this record as a Header Record.
5–15	*Blanks.* Leave these positions blank.
16	*Dash.* Enter a dash (–).
17–19	*Reel Sequence Number.* Enter a three digit number indicating the sequence of this reel within the file. Number sequentially beginning with 001.
20	*Blank.* Leave this position blank.
21–30	*To Job Number.* Enter the constant "1550102000".
31–35	*Creation Date (YYDDD).* Enter the date the file was created. YY indicates the low order digit of the year and DDD the Julian day of the year, from 001–366.
36	*Dash.* Enter a dash (–).
37–39	*Retention Period.* Enter the constant "100". This indicates the maximum period that this tape will be held for entry into the program.
40	*Blank.* Leave this position blank.
41–50	*From Job Number.* Enter the constant "AGENCY-nnn" where "nnn" is the agency code assigned for TDA requests.
51–80	*Blanks.* Leave these positions blank.

Enter a tape mark following the Header Record.
(b) *Data Record(s)*

Position(s)	*Contents*
1	*Blank.* Leave this position blank.
2–4	*Project Code.* Enter the constant "155".
5–7	*Agency Code.* Enter the three digit number assigned at the time of initial negotiation. Use only the agency code assigned for TDA requests.
8	*TIN Indicator.* Enter "2" if EIN or "0" if SSN.
9–17	*TIN.* Enter the nine digit EIN or SSN which will be used for matching will the BMF.
18–43	*Agency Case Control Number.* The field is provided for the use of the customer and may contain any alphabetic or numeric data needed for control purposes, or may be used as a reference

Position(s)	*Contents*
	field, at the discretion of the customer. Output data will be sorted in alpha-numeric sequence by the first nine positions of this field. Leave positions 18–26 blank if you desire your output in sequence by TIN.
44–45	*Blanks*. Leave these positions blank.
46–49	*Name Control*. Enter the four character Name Control which will be used for matching with the BMF.
50–80	*Blanks*. Leave these positions blank.

Enter a tape mark following the last data record on a reel.

(c) *Trailer Record*

Position(s)	*Contents*
1–4	*Trailer Record I.D.* Enter the constant "IEOR" or "IEOF" to identify this tape record as the trailers record. Use "IEOR" to signify the end of a reel and "IEOF" to signify the end of a file.
5	*Blank*. Leave this position blank.
6–10	*Block Count*. Enter the number of data blocks on this reel of tape.
11–20	*Reel Record Count*. For customer's use (no entry required).
21–30	*Reel Hash Count*. for customer's use (no entry required)
31–40	*File Record Count*. For customer's use (no entry required).
41–80	*Blanks*. Leave these positions blank.

Enter a tape mark following the trailer record.

.04 BMF Address Requests

(a) *Header Record*

Position(s)	*Contents*
1–4	*Header Label I.D.* Enter the constant "IHDR" to identify this record as a Header Record.
5–15	*Blanks*. Leave these positions blank.
16	*Dash*. Enter a dash (–)
17–19	*Reel Sequence Number*. Enter a three digit number indicating the sequence of this reel within the file. Number sequentially beginning with 001.
20	*Blank*. Leave this position blank.
21–30	*To Job Number*. Enter the constant "1550101000".
31–35	*Creation Date (YYDDD)*. Enter the date the file was created. YY indicates the low order digits of the year and DDD the Julian day of the year, from 001–366.
36	*Dash*. Enter a dash (–)
37–39	*Retention Period*. Enter the constant "100". This indicates the maximum period that this tape will be held for entry into the program.
40	*Blank*. Leave this position blank.
41–50	*From Job Number*. Enter the constant "AGENCY-nnn" where "nnn" is the agency code number assigned for BMF address requests.
51–80	*Blanks*. Leave these positions blank.

Enter a tape mark following the Header Record.

(b) *Data Records*

Position(s)	*Contents*
1	*Blank*. Leave this position blank.
2–4	*Project Code*. Enter the constant "155".

Position(s)	*Contents*
5–7	*Agency Code*. Enter the three digit number assigned at the time of initial negotiation. Use only the agency code assigned for BMF address requests.
8	*TIN Indicator*. Enter "2" if EIN or "0" if SSN.
9–17	*TIN*. Enter the nine digit EIN or SSN which will be used for matching with the BMF.
18–43	*Agency Case Control Number*. This field is provided for the use of the customer and may contain any alphabetic or numeric data needed for control purposes, or may be used as a reference field, at the discretion of the customer. Output data will be sorted in alpha-numeric sequence by the first nine positions of this field. Leave positions 18–26 blank if you desire your output in sequence by TIN.
44–45	*Blanks*. Leave these positions blank.
46–49	*Name Control*. Enter the four character Name Control which will be used for matching with the BMF.
50–80	*Blanks*. Leave these positions blank.

Enter a tape mark following the last data record on a reel.

(c) *Trailer Record*

Positions	*Contents*
1–4	*Trailer Record I.D.* Enter the constant "IEOR" or "IEOF" to identify this tape record as the trailer record. Use "IEOR" to signify the end of a reel and "IEOF" to signify the end of a file.
5	*Blank*. Leave this position blank.
6–10	*Block Count*. Enter the number of data tape blocks in the reel of tape.
11–20	*Reel Record Count*. For customer's use (no entry required).
21–30	*Reel Hash Count*. For customer's use (no entry required).
31–40	*File Record Count*. For customer's use (no entry required).
41–80	*Blanks. Leave these positions blank.*

Enter a tape mark following the trailer record.

.05 IMF TDA Requests

(a) *Header Record*

Positions	*Contents*
1–4	*Header Label I.D.* Enter the constant "IHDR" to identify this record as a Header Record.
5–15	*Blanks*. Leave these positions blank.
16	*Dash*. Enter a dash (–).
17–19	*Reel Sequence Number*. Enter a three digit number indicating the sequence of this reel within the file. Number sequentially beginning with 001.
20	*Blank*. Leave this position blank.
21–30	*To Job Number*. Enter the constant "4550101000".
31–35	*Creation Date (YYDDD)*. Enter the date the file was created. YY indicates the low order digits of the year and DDD the Julian day of the year, from 001–366.
36	*Dash*. Enter a dash (–).
37–39	*Retention Period*. Enter the constant "100". This indicates the maximum period that this tape will be held for entry into the program.
40	*Blank*. Leave this position blank.
41–50	*From Job Number*. Enter the constant "4550111000".
51–80	*Blanks*. Leave these positions blank.

Enter a tape mark following the Header Record.

(b) *Data Record(s)*

Positions	*Contents*
1	*Blank*. Leave this position blank.
2–4	*Project Code*. Enter the constant "455" to identify this as a IMF TDA request.
5–7	*Agency Code*. Enter the three digit number assigned at the time of initial negotiation. Use only the agency code assigned for TDA request.
8	*Blank*. Leave this position blank.
9–17	*Social Security Number*. Enter the nine digit Social Security Number which will be used for matching with the IMF.
18–43	*Agency Case Control Number*. This field is provided for the use of the customer and may contain any alphabetic or numeric data needed for control purposes, or may be used as a reference field, at the discretion of the customer. Output data will be sorted in alpha-numeric sequence by the first nine positions of this field. Leave positions 18–26 blank if you desire your output in sequence by SSN.
44–45	*Blanks*. Leave these positions blank.
46–49	*Name Control*. Enter the four character Name Control which will be used for matching with the IMF.
50–80	*Blanks*. Leave these positions blank.

Enter a tape mark following the last data record on a reel.

(c) *Trailer Record.*

Positions	*Contents*
1–4	*Trailer Record I.D.* Enter the constant "IEOR" or "IEOF" to identify this tape record as the trailer record. Use "IEOR" to signify the end of a reel and "IEOF" to signify the end of a file.
5	*Blank*. Leave this position blank.
6–10	*Block Count*. Enter the number of data tape blocks in the reel of tape.
11–20	*Reel Record Count*. For customer's use (no entry required).
21–30	*Reel Hash Count*. For customer's use (no entry required)
31–40	*File Record Count*. For customer's use (no entry required).
41–80	*Blank*. Leave these positions blank.

Enter a tape mark following the trailer record.

.06 IMF Address Requests

(a) *Header Record*

Positions	*Contents*
1–4	*Header Label I.D.* Enter the constant "IHDR" to identify this tape record as a Header Record.
5–15	*Blanks*. Leave these positions blank.
16	*Dash*. Enter a dash (–).
17–19	*Reel Sequence Number*. Enter a three digit number indicating the sequence of this reel within the file. Number sequentially beginning with 001.
20	*Blank*. Leave this position blank.
21–30	*To Job Number*. Enter the constant "7190701000".
31–35	*Creation Date (YYDDD)*. Enter the date the file was created. YY indicates the low order digits of the year and DDD the Julian day of the year, from 001–366.
36	*Dash*. enter a dash (–).
37–39	*Retention Period*. Enter the constant "100". This indicates the maximum period that this tape will be held for entry into the program.
40	*Blank*. Leave this position blank.
41–50	*From Job Number*. Enter the constant "7190101000".

Position(s)	*Contents*
51–80	*Blanks*. Leave these positions blank.

Enter a tape mark following the Header Record.

(b) *Data Records(s)*

Positions	*Contents*
1	*Blank*. Leave this position blank.
2–4	*Project Code*. Enter the constant "719" which identifies this as an IMF Address Request.
5–7	*Agency Code*. Enter the three digit number assigned at the time of initial negotiation. Use only the agency code assigned for IMF Address request.
8–16	*Social Security Number*. Enter the nine digit Social Security Number which will be used for matching with the IMF.
17–42	*Agency Case Control Number*. This field is provided for the use of the customer and may contain any alphabetic or numeric data needed for control purposes, or may be used as a reference field, at the discretion of the customer. Output data will be sorted in alpha-numeric sequence by the first nine positions of this field. Leave positions 17–25 blank if you desire your output in sequence by SSN.
43–44	*Magnetic Tape Code*. Enter the two digit code assigned by the Service.
45–48	*Name Control*. Enter the four character Name Control which will be used for matching with the IMF.
49–50	*Blanks*. Leave these positions blank.

Enter a tape mark following the last data record on a reel. If it is necessary to pad the last block, pad with 9's.

(c) *Trailer Record*

Positions	*Contents*
1–4	*Trailer Label I.D.* Enter the constant "IEOR" or "IEOF" to identify this tape record as the trailer record. Use "IEOR" to signify the end of a reel and "IEOF" to signify the end of a file.
5	*Blank*. Leave this position blank.
6–10	*Block Count*. enter the number of data tape blocks in the reel of tape.
11–80	*Blanks*. Leave these positions blank.

Enter a tape mark following the trailer record.

SEC. 12. RETURN OF OUTPUT TAPES

.01 Output tapes will be returned to the requesting agency at the address provided on the Form 5181. Output tapes will be returned approximately three weeks after the original due date at NCC.

.02. Tapes will be formatted according to the type of request. See Section 13 for specific formats.

.03 Separate tapes will be returned for each type of request submitted.

.04 Each output tape will be labeled with the following information:

a) Agency Name
b) Tape Reel Identification Number
c) Assigned Agency Code Number for type of request
d) IMF or BMF extract
e) Address or TDA request.

SEC. 13. OUTPUT TAPE SPECIFICATIONS

.01 Output tape will have the following characteristics:

a) 9 track
b) 1600 BPI
c) Extended binary coded decimal (EBCDIC)
d) Odd Parity

.02 Each tape reel will contain the following types of records:

Header Record
Tape Mark (after the Header Record)
Data Records. Tape Blocks separated from each other by an interrecord gap.
Tape Mark after the last Data Record on a tape.
Trailer Record
Tape Mark

Each tape reel may consist of one or more sets of data blocks.

.03 BMF TDA Requests

(a) *Header Record*

Positions	*Contents*
1–4	*Header Label I.D.* constant "IHDR".
5–15	*Blanks.*
16	*Dash* (–).
17–19	*Reel Sequence Number.* As input.
20	*Blank.*
21–30	*To Job Number.* Will appear as constant "TDA CHECK".
31–35	*Creation Date (YYDDD).* This is the date of the BMF extract. The YY represents the low order digits of the year and DDD is the Julian day of the year, from 001–366.
36	*Dash* (–).
37–39	*Retention Period.* Constant "100".
40	*Blank.*
41–50	*From Job Number.* Will appear as constant "1550512000".
51–80	*Blanks.*

(b) *Data Record(s)*

Positions	*Contents*
1–4	*Record Length.* Service use only.
5	*Separation Code.* Service use only.
6–8	*Project Code.* Constant "155".
9–11	*Agency Code.* As input.
12	*TIN Indicator.* As input.
13–21	*TIN. As input.*
22–47	*Agency Case Control Number.* As input.
48–49	*Blanks.*
50–53	*Name Control.* As input.
54	*Blank.*
55	*Delinquency Indicator.* This field indicates the TDA status of the account on the BMF. The codes in this field have the following meanings: "Y"—indicates delinquency status. "N"—no indication of delinquency status. "blank"—no match obtained at the Master File with the TIN/Name Control combination provided.
56–80	*Blanks.*

A tape mark will appear following the last data record on a reel.

(c) *Trailer record*

Positions	*Contents*
1–4	*Trailer Record I.D.* Constant "IEOR" or "IEOF".
5	*Blank.*
6–10	*Block Count.* As input.
11–20	*Reel Record Count.* As input (entry not required).
21–30	*Reel Hash Count.* As input (entry not required).
31–40	*File Record Count.* As input (entry not required).
41–80	*Blanks.*

A tape mark will appear following the trailer record.

.04 BMF Address Requests

(a) *Header Record*

Positions	*Contents*
1–4	*Header Label I.D.* Constant "IHDR".
5–15	*Blanks.*
16	*Dash* (–).
17–19	*Reel Sequence Number.* As input.
20	*Blank.*
21–30	*To Job Number.* Will appear as constant "NAME ADDR".
31–35	*Creation Date (YYDDD).* This is the date of the BMF extract. The YY represents the low order digits of the year and DDD is the Julian day of the year, from 001–366.
36	*Dash* (–).
37–39	*Retention Period.* Constant "100".
40	*Blank.*
41–50	*From Job Number.* Will appear as the constant "1550511000".
51–80	*Blanks.*

A tape mark will appear following the Header Record.

(b) *Data Records*

Positions	*Contents*
1–4	*Record Length.* Service use only.
5	*Separation Code.* Service use only.
6–8	*Project Code.* Constant "155".
9–11	*Agency Code.* As input.
12	*TIN Indicator.* As input.
13–21	*TIN. As input.*
22–47	*Agency Case Control Number.* As input.
48–49	*Blanks.*
50–53	*Name Control.* As input.
54–55	*Blanks.*
56–90	*First Name Line.* The name provided is that which was entered by the taxpayer on the most recent tax return. Subsequent name lines may be blank or may show a continuation of the first name line. They may also show information such as "in care of John Doe" or "John Doe, Executor". If the input EIN or Name Control do not match with the corresponding fields on the Master File—"***NO RECORD EIN***" or "***NO RECORD NC***" will appear in the first name line field.
91–125	*Second Name Line.*
126–160	*Third Name Line.*
161–195	*Fourth Name Line.*
196–230	*Street Address.*
231–250	*City.*
251–252	*State Code.*
253–257	*Zip Code*

These fields will show the latest street address, Post Office Box number, or other address, city, state and Zip Code furnished by the taxpayer on a tax return or a notice of change of address provided to IRS by the taxpayer.

Zeros in all five positions of the Zip Code indicate that the taxpayer did not provide a valid Zip Code and the city or town could not be located in the Zip Code Master File maintained by the Service. Zeros in the last two positions indicate that only the area code (the first three digits) could be determined.

A tape mark will follow the last data record on the reel.

(c) *Trailer Record*

Positions	*Contents*
1–4	*Trailer Record I.D.* Constant "IEOR" or "IEOF".
5	*Blank.*
6–10	*Block Count.* As input.
11–20	*Reel Record Count.* As input (entry not required).
21–30	*Reel Hash Count.* As input (entry not required).
31–40	*File Record Count.* As input (entry not required).
41–80	*Blanks.*

A tape mark will appear following the trailer record.

.05 IMF TDA Requests

(a) *Header Record*

Position(s)	*Contents*
1–4	*Header Label I.D.* Constant "IHDR".
5–15	*Blanks.*
16	*Dash* (–).
17–19	*Reel Sequence Number.* As input.
20	*Blank.*
21–30	*To Job Number.* Will appear as constant "4550901000".
31–35	*Creation Date.* (YYDDD) This is the date of the IMF extract. The YY represents the low order digits of the year and DDD represents the Julian day of the year, from 001–366.
36	*Dash* (–).
37–39	*Retention Period.* Constant "100".
40	*Blank.*
41–50	*From Job Number.* Will appear as constant "4550711000".
51–80	*Blanks.*

A tape mark will appear following the Header Record.

(b) *Data Record(s)*

Position(s)	*Contents*
1	*Blank*
2–4	*Project Code.* Constant "455".
5–7	*Agency Code.* As input.
8	*Blank.*
9–17	*SSN.* As input.
18–43	*Agency Case Control Number.* As input.
44–45	*Blanks.*
46–49	*Name Control.* As input.
50	*Blanks.*
51	*Delinquency Indicator.* This field indicates the TDA status of the account on the IMF. The codes in this field have the following meanings: "Y"—indicates delinquency status. "N"—no indication of delinquency status. "blank"—no match obtained at the Master File with the SSN/Name Control combination provided.
52–80	*Blanks.*

A tape mark will appear following the last data record on a reel.

(c) *Trailer Record*

Position(s)	*Contents*
1–4	*Trailer Record I.D.* Constant "IEOR" or "IEOF".
5	*Blank.*
6–10	*Block Count.* As input.
11–20	*Reel Record Count.* As input (entry not required).
21–30	*Reel Hash Count.* As input (entry not required).
31–40	*File Record Count.* As input (entry not required).
41–80	*Blanks.*

A tape mark will appear following the trailer record.

.06 IMF Address Requests

(a) *Header Record*

Position(s)	*Contents*
1–4	*Header Label I.D.* Constant "IHDR".
5–15	*Blanks.*
16	*Dash* (–).
17–19	*Reel Sequence Number.* As input.
21–30	*To Job Number.* Will appear as constant "7192501000".
31–35	*Creation Date.* (YYDDD) This is the date of the IMF extract. The YY represents the low order digits of the year and DDD represents the Julian day of the year, 001-366.
36	*Dash* (–).
37–39	*Retention Period.* Constant "100".
40	*Blank.*
41–50	*From Job Number.* Will appear as the number of the Service file that created the extract.
51–80	*Blanks.*

A tape mark will appear following the Header Record.

(b) *Data Record(s)*

Position(s)	*Contents*
1–4	*Record Length.* Service use only.
5	*IRS Code.* Service use only.
6–7	*Magnetic Tape Code.* As input.
8–10	*Agency Code.* As input.
11	*IRS Code.* Service use only.
12–14	*Blanks.*
15–23	*Social Security Number.* As input.
24–49	*Agency Case Control Number.* As input.
50–84	*First Name Line.* The name provided is that which was entered by the taxpayer on the most recent tax return. Subsequent name lines may be blank or may show a continuation of the first name line. They may also show information such as "in care of John Doe" or "John Doe, Executor". If the input SSN (or SSN extracted from the Spouse-Primary SSN Record File) or Name Control do not match with the corresponding fields on the corresponding fields on the Master File "***NO RECORD SSN***" or "***NO RECORD NC***" will appear in the first name line field.
85–119	*Second Name Line.*

Positions	*Contents*
120–154	*Street Address.*
155–179	*City and State.*
180–184	*Zip Code.*

These fields will show the latest street address, Post Office Box number, or other address, city, state and Zip Code furnished by the taxpayer on a tax return or a notice of change of address provided to IRS by the taxpayer.

Zeros in all five positions of the Zip Code indicate that the taxpayer did not provide a valid Zip Code and the city or town could not be located in the Zip Code Master File maintained by the Service. Zeros in the last two positions indicate that only the area code (the first three digits) could be determined.

185–188	*Name Control.* As input.
189–190	*Year of Latest Tax Activity. State agency use, otherwise, blank.*
191	*Service Use Only.*
192–212	*Blanks.*

A tape mark will appear following the last data record on a reel.

(c) *Trailer Record*

Position(s)	*Contents*
1–4	*Trailer Label I.D.* Constant "IEOR" or "IEOF"
5	*Blank.*
6–10	*Block Count.* As input.
11–30	*Zeros.*
31–80	*Blanks.*

A tape mark will appear following the trailer record.

SEC. 14. USE OF REQUEST OUTPUT

.01 Users should be aware of the limitations of the delinquency indication. It reflects only the Master File status of the account at the time of the extract. For instance, the account could show delinquency status but a payment agreement could have been recently established between the Service and the taxpayer. Or the extract could show an account as delinquent but by the time the agency receives the output or is ready to use the information, the delinquent amount may have been paid.

.02 There is also the possibility that a taxpayer may be delinquent but in an amount less than that which creates a delinquency indication on the Master File. In such a case, the extract will indicate that the taxpayer's account is not in delinquent status.

.03 Requestors should take care to provide correct information to the Service. They should be aware that if they fail to do so, there is the slight possibility that through coincidental circumstances, the data provided may not be that of the individual for whom the request was made. For instance, if information is requested for John Smith, but an erroneous SSN is provided which happens to be that of a Joe Smith, the Master File will match the account of Joe Smith and the data provided will reflect that account.

SEC. 15. DETERMINING A NAME CONTROL

.01 Each input data record will require a name control. Determine according to the following instructions.

.02 Individuals

a) The name control of an individual is the first four significant characters of the last name (including hyphens). In surnames of less than four characters, the remaining positions are blank. Disregard blanks or apostrophes between letters.

Individual Name	*Name Control*
John A. Fir	FIR
James P. Ai	AI
John A. El-Oak	EL-O
Mary Van Elm	VANE
Joe McCedar	MCCE
Ann O'Spruce	OSPR
Dorothy Willow	WILL
Mr. John Holly	HOLL
Harry Maple, Owner	MAPL
Pfc. M. Ralph Evergreen	EVER
John DiPine	DIPI
Mark D'Oak	DOAK
John De la Rose	DELA

.03 Corporations

a) The name control of a corporation is derived from the first four significant characters of the name.

b) An exception to this rule is to exclude the word "the" when used as a prefix to the name and the word "the" is followed by more than one word.

c) In instances where a numeric is followed by a decimal (.) as part of the name, replace the decimal point (.) with a hyphen (–) when determining the name control

Business Name	*Name Control*
John Field Plows Inc.	JOHN
The Meadowlark Co.	MEAD
The Opah	THEO
The 813 Club Inc.	813C

Business Name	*Name Control*
11th Street Inc.	11TH
P & P Company	P&PC
Y–Z Drive Co.	Y–ZD
RS Corporation	RSCO
ZZZ Club	ZZZC
J.R. Olive Inc.	JROL
Pier Pickle Ltd.	PIER
18.8 Acres, Inc.	18–8

.04 Partnerships

a) Derive the name control for partnership entities from the legal name of the partnership. If the legal name contains the name of a partner, derive the name control from the surname of the first listed partner. If the legal name does not contain the name of a partner, derive the name control from the first four characters in the legal name. Do not use a trade name (doing business as) to determine name control.

.05 Other Organizations

a) Unions, municipal groups, churches, lodges, associations, tax exempt organizations, foundations, funds and other like entities are assigned name controls as if corporate names. Chapter, department and local designations should be ignored.

Organization	*Name Control*
Scottish Rite of Free Heather	SCOT
Ice Wagon Drivers Helpers Union	ICEW
(The) Shrine of the Little River Church	SHRI
NCO Open Mess Bldg.-000	NCOO
Piranha Pension Plan Board of Trustees	PIRA
Ibex Foundation	IBEX
Seattle Local 55 Veterans of Space Wars	VETE
Local 210 International Orchid Assn.	INTE
Diocese of Roseville, St. Violet's Hospital	STVI

b) Political activity entities should be name controlled as a corporation unless the entity is an individual's name.

Organization	*Name Control*
Sinking Fund Commission of the City of Lillipput	SINK
Phineous Kudzu Campaign Fund	KUDZ

.06 Estates

Derive the Name Control from the surname of the decedent.

SEC. 16. SCHEDULES

.01 Master File extracts will be made monthly. The current NCC extract schedule will be provided as a part of the contracting process.

.02 The Master File extract process requires approximately two and one half weeks. Output tapes will be mailed from NCC approximately three weeks from the tape received due dates provided with your contract. Forms 4453 will be mailed from Service Centers approximately six weeks from the punch card received due dates specified above.

.03 Processing schedules are not flexible. Agencies are responsible for assuring that input is received in ample time to be included in the month's processing. Input received late will be processed in the next month.

SEC. 17. REIMBURSEMENT

All work done by the Service for agencies will be performed on a reimbursable basis. Billing will be based on the number of data records processed and the number of Service tapes required for output. The cost per data record is tentatively projected to be four cents ($.04) for requests. The cost per Service tape will be $12.

SEC.18. QUESTIONS

Any questions regarding the material in this Revenue Procedure can be addressed to the Internal Revenue Project Coordinator.

SEC. 19. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 84-20, 1984-1 C.B. 434, is superseded.

Exhibit A

Form **5181** (Rev. June 1985) Department of the Treasury Internal Revenue Service	**Agreement Covering Reimbursable Services** *See "Terms and Conditions" on reverse*	Project Number

1. Name of organization requesting services on reimbursable basis	2. Address

3. Project title or type of service requested

4. Internal Revenue Project Coordinator	5. Project Coordinator of Requesting Organization
a. Name and title	a. Name and title
b. Address	b. Shipping Address *(No., Street, City, State, ZIP Code)*
c. Telephone	c. Telephone

6. Cost and Financing	a. Total estimated cost of services $
	b. Method of Billing ☐ In advance ☐ Actual cost to be billed as work is completed ☐ Other *(Explain)*

Federal Government Agencies are required to make payment by Standard Form 1081, and must ensure inclusion of their Agency Locator Code (ALC). All other organizations, i.e., municipal, state governments and corporations, will send payment by check drawn to order of **Accounting Section, Internal Revenue Service,** _____.
(Address)

7. Period of Agreement	This agreement shall become effective on the date approved by the Government and shall not extend beyond the end of the Government fiscal year or_____. For a renewal, apply to the Internal Revenue Project Coordinator.

8. For Internal Revenue Use Only		9. For Use of Requesting Organization	
a. Approved by *(signature)*		a. Accepted by *(Signature of Authorized Official)*	
b. Title	c. Date	b. Title	c. Date

Terms and Conditions

1. The authority to perform services on a cost basis is contained in Section 6103(p)(2) and Section 6108(b) of the Internal Revenue Code (IRC). The performance of services is authorized only when consistent with the basic public obligations of the Internal Revenue Service (the Service). If necessary to fulfill its public obligations, the Service may reject or terminate any part of this agreement and return the unused balance of funds advanced.

2. Although every reasonable effort is made to avoid delays and errors in the performance of its work, the Service is not responsible for delays or errors in the services performed. The cost of data recompilations or corrections must be paid for by the requesting party.

3. Direct and indirect actual costs will be charged for reimbursable work. If funds advanced to the Service are more than the actual cost of performing the work, the difference will be returned. If an estimate is less than the actual costs incurred, the requesting organization agrees to pay for the actual costs incurred.

4a. Section 6103(p)(4) of the IRC provides specific requirements for Federal, state and local organizations to safeguard Federal returns and return information as a condition for receiving the information.

b. Section 7213 of the IRC makes illegal disclosure of returns or return information a felony punishable by a fine not to exceed $5000 or imprisonment of not more than 5 years, or both, together with the costs of prosecution. IRC Section 7431 makes persons liable for civil damages who knowingly or negligently disclose returns or return information illegally.

5. The Service reserves the right to use a copy of all data provided under this agreement.

6. The requester may cancel this agreement only by giving the Service written notice 30 days before cancellation. Payment to the Service shall include actual costs to the date of cancellation. The Service will exercise due diligence to prevent incurring costs after the cancellation date. However, payment shall also be made for unavoidable commitments up to the date the agreement would have expired.

Exhibit B

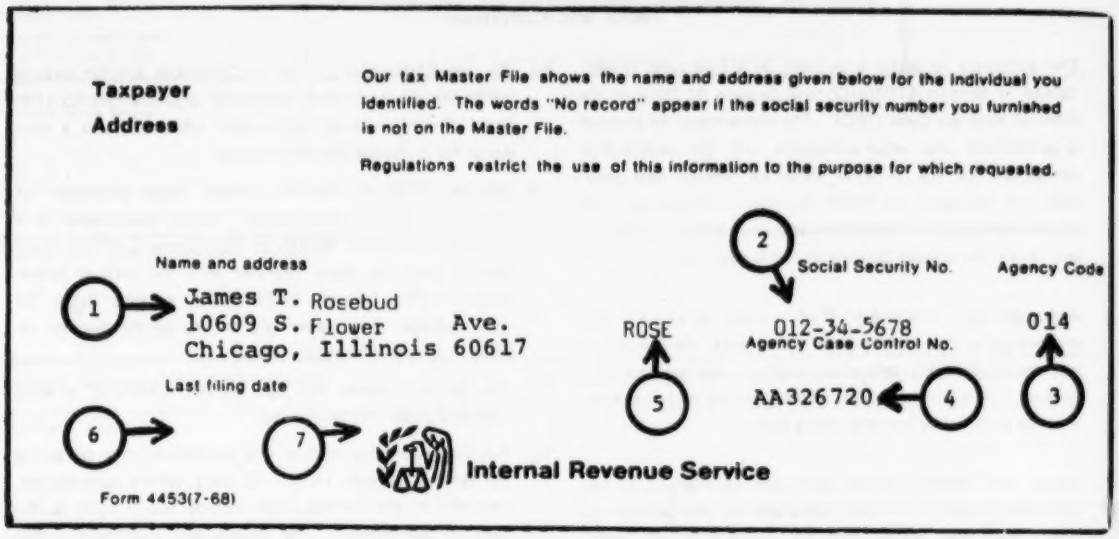
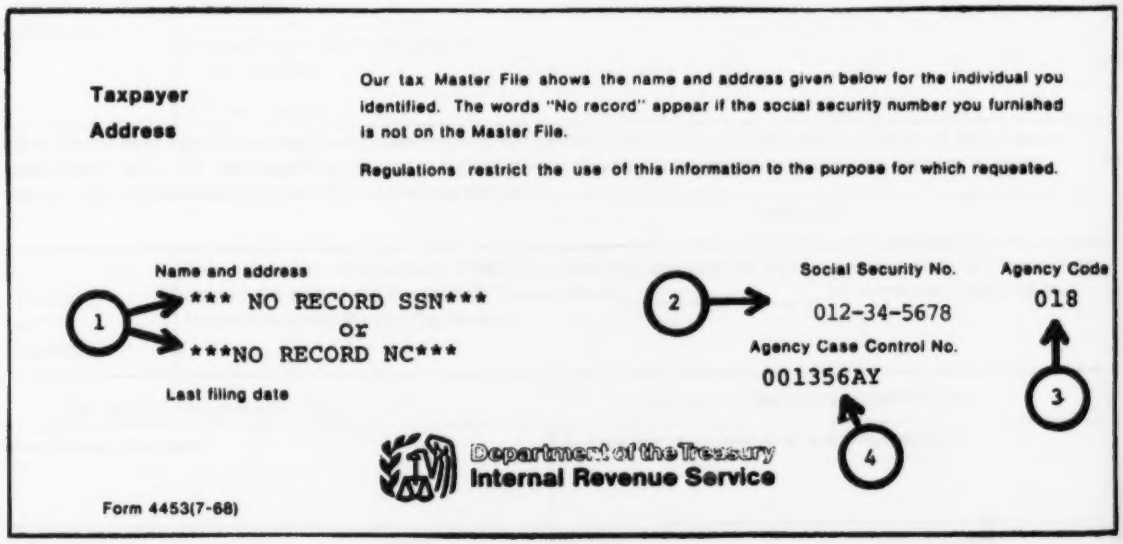

Taxpayer
Address
Our tax Master File shows the name and address given below for the individual you identified. The words "No record" appear if the social security number you furnished is not on the Master File.
Regulations restrict the use of this information to the purpose for which requested.
Name and address
James T. Rosebud
10609 S. Flower Ave.
Chicago, Illinois 60617
Social Security No.
012-34-5678
Agency Code
014
ROSE
Agency Case Control No.
AA326720
Last filing date
Internal Revenue Service
Form 4453(7-68)

Exhibit C


Taxpayer
Address
Our tax Master File shows the name and address given below for the individual you identified. The words "No record" appear if the social security number you furnished is not on the Master File.
Regulations restrict the use of this information to the purpose for which requested.
Name and address
*** NO RECORD SSN***
or
NO RECORD NC
Last filing date
Social Security No.
012-34-5678
Agency Code
018
Agency Case Control No.
001356AY
Department of the Treasury
Internal Revenue Service
Form 4453(7-68)

26 CFR 601.201: Rulings and determination letters.
(Also Part 1, Section 368; 1.368-2.)

Rev. Proc. 85-34

SECTION 1. BACKGROUND

Rev. Proc. 85-22, 1985-1 C.B. 550, sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue Service. Section 5 of Rev. Proc. 85-22 is entitled, Areas Under Extensive Study in Which Rulings or Determination Letters Will Not be Issued Until the Service Resolves the Issue Through Publication of a Revenue Ruling, Revenue Procedure, Regulations or Otherwise.

Section 5.19 provides:

Section 368.—Definitions relating to Corporate Reorganizations.—Whether the conversion of a financial institution from mutual to stock will qualify under section 368(a)(1)(G) and section 368(a)(3)(D) of the Code, unless the stock of the converted financial institution is acquired by a financial institution to which either section 585 or section 593 of the Code applies.

SEC. 2. PROCEDURE

Rev. Proc. 85-22 is hereby modified by deleting section 5.19.

SEC. 3. EFFECTIVE DATE

This revenue procedure is effective July 22, 1985, the date of publication of this revenue procedure in the Internal Revenue Bulletin.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 85-22 is modified.

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part 1, Section 692; 1.692-1.)

Rev. Proc. 85-35

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide guidance for representatives of certain military or civilian employees of the United States who have died as a result of injuries incurred outside the United States in a terroristic or military action. Procedures are provided for having tax forgiven or for claiming refunds of tax under section 692(c) of the Internal Revenue Code.

SEC. 2. BACKGROUND

.01 Pub. L. No. 98-259, 1984-1 C.B. 313 (the Act), as amended by the Tax Reform Act of 1984, Pub. L. No. 98-369, section 722(g), 98 Stat. 494, 1984-3 C.B. (Vol. 1) 1, 482, enacted section 692(c) of the Internal Revenue Code. Section 692(c)(1) provides, in the case of any individual who dies while a military or civilian employee of the Unted States, if such death occurs as a result of wounds or injury while the individual was a military or civilian employee and which was incurred outside the United States in a terroristic or military action, that any tax imposed by subtitle A of the Code (income tax) shall not apply with respect to the taxable year in which falls the date of death and with respect to any prior taxable year in the period beginning with the last taxable year ending before the taxable year in which the wounds or injury were incurred.

.02 Section 692(c)(2) of the Code defines "terroristic or military action" as any terroristic activity which a preponderance of the evidence indicates was directed against the United States or any of its allies and any military action involving the Armed Forces of the United States and resulting from violence or aggression against the United States or any of its allies (or threat thereof).

.03 Under section 1(b)(1) of the Act, section 692(c) of the Code applies to all taxable years of individuals dying after December 31, 1979, as a result of wounds or injuries incurred after that date. The general period of limitations set forth in section 6511 applies to claims made under the Act. However, under section 1(b)(2) of the Act, in a case in which the general period of limitations has expired or will otherwise expire before April 10, 1985, the period of limitations will not expire before April 10, 1985.

.04 Section 722(g) of the Tax Reform Act of 1984 amended the Act to change the effective date from December 31, 1979, to November 17, 1978, and to include the Director General of the Multinational Force and Observers in the Sinai as a civilian employee. Under section 722(g)(5)(B), claims for refund for persons affected by these changes may be made by July 18, 1985, if the period of limitations would otherwise have expired before then.

SEC. 3. PROCEDURE

.01 In the case of any employee for whom no U.S. Individual Income Tax Return (Form 1040, 1040A or 1040EZ) has been filed, tax may be forgiven and a claim for refund of any withheld income tax or estimated tax payments should be made by filing Form 1040 with the Internal Revenue Service Center, P.O. Box 267, Covington, KY 41019, Attn: Stop 2. The phrase "KITA—see attached" should be entered on the line for "Total tax" (line 56 on the 1983 form). The attachment should include a computation of the tax liability before application of section 692(c) of the Code and the amount being forgiven under that section. On joint returns reporting taxable income of the surviving spouse, an allocation of tax between spouses must be made. *See* Section 1.692-1(b) of the Income Tax Regulations and Rev. Rul. 85-103, page 176, this Bulletin. If the surviving spouse or other person filing the joint return is unable to determine the proper allocation, statement of all income and deductions allocable to each spouse should be attached and the Internal Revenue Service will make the proper allocation. All returns must be accompanied by Form W-2, Wage and Tax Statement.

.02 In the case of any employee for whom a U.S. individual income tax return has already been filed (for example, in the case of a year for which the return was filed before enactment of the Act), claims for refund should be made by filing Form 1040X, Amended U.S. Individual Income Tax Return, with the Internal Revenue Service Center, P.O. Box 267, Covington, KY 41019, Attn: Stop 2. Separate Forms 1040X should be filed for each year in question. The phrase "KITA—see attached" should be entered on line 12, "Total tax liability". The attachment should include a computation of the tax liability before application of section 692(c) of the Code and the amount being forgiven under that section. In the case of joint returns reporting taxable income of the surviving spouse, an allocation of tax between spouses must be made. *See,*

section 1.692-1(b) of the regulations and Rev. Rul. 85-103. If the surviving spouse or other person filing the claim for refund is unable to determine the proper allocation, a statement of all income and deductions allocable to each spouse should be attached and the Service will make the proper allocation.

.03 All returns and claims for refund should be identified by writing "K I T A" in bold letters on the top of page 1 of the return or claim for refund.

.04 All returns and claims for refunds must be accompanied by the following documents:

1. Form 1310, Statement of Person Claiming Refund Due a Deceased Taxpayer;

2. A certification from the Department of Defense or the Department of State that the death was the result of terroristic or military action outside the United States. In the case of military employees and civilian employees of the Department of Defense, certification must be made by the Department of Defense on Form DOD 1300. In the case of civilian employees of all other agencies, certification must be made in the form of a letter signed by the Director General of the Foreign Service, Department of State, or his/her delegate. In either case, the certification must include the name and social security number of the individual, the date of injury, the date of death, and a statement that the individual died as the result of a military or terroristic action outside the United States and was an employee of the United States at the date of injury and at the date of death.

.05 In a case in which a decedent has been certified as having died as the result of military or terroristic action outside the United States, but the decedent's representative does not have enough tax information to file a timely claim for refund, the representative may stop the running of the period of limitations for making such a claim by filing Form 1040X with the Internal Revenue Service, Covington, Ky 41019, Attn: Stop 2, attaching Form 1310, and attaching a statement that an amended claim will be filed as soon as the requisite information is ascertained.

SEC. 4. INQUIRIES

Inquiries concerning this revenue procedure should be addressed to the Commissioner of Internal Revenue, attention D:R:R:1, 1111 Constitution Ave., N.W., Washington D.C. 20224.

SEC. 5. EFFECTIVE DATE

This revenue procedure is effective for all returns or claims for refunds filed as the result of the Act, as amended.

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part 1, Sections 446, 471, 481; 1.446-1, 1.471-1, 1.481-5.)

Rev. Proc. 85-36

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide a procedure whereby certain taxpayers who are required to use inventories in order to clearly determine income may obtain expeditious consent to change their overall method of accounting from the cash receipts and disbursements method to the accrual method. Taxpayers complying with this revenue procedure will be deemed to have obtained the consent of the Commissioner of Internal Revenue to change their method of accounting.

SEC. 2. BACKGROUND

01. Section 471 of the Internal Revenue Code requires the use of inventories when in the opinion of the Commissioner it is necessary in order clearly to determine income. Section 1.471-1 of the Income Tax Regulations provides that in order clearly to determine income, inventories at the beginning and end of each tax year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor.

.02 Section 1.446-1(c)(2) of the regulations provides that when taxpayers are required to use inventories in order to clearly determine income they must use the accrual method of accounting with regard to purchases and sales.

.03 Section 446(e) of the Code and section 1.446-1(e) of the regulations state that, except as otherwise provided, in order to change a method of accounting for federal income tax purposes a taxpayer must obtain the consent of the Commissioner. Section 1.446-1(e)(3)(i) requires that in order to obtain this consent, generally an application, Form 3115, Application for Change in Accounting Method, must be filed within 180 days after the beginning of the tax year in which the proposed change is to be made. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to a change in its method of accounting in accordance with section 446(e).

.04 Section 481(a) of the Code requires that those adjustments necessary to prevent amounts from being duplicated or omitted be taken into account when the taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding tax year. Section 481(c) and section 1.481-5 of the regulations provide that the adjustment required by section 481(a) may be taken into account in determining taxable income in the manner and subject to the conditions agreed to by the Commissioner and the taxpayer.

.05 Section 6.02 of Rev. Proc. 84-74, 1984-2 C.B. 736 defines a Category A method of accounting as a method of accounting that is specifically not permitted to be used by the taxpayer by the Code, regulations, or a decision of the Supreme Court of the United States, or a method that is clearly erroneous. The overall use of the cash receipts and disbursements method of accounting when inventories are required in order to clearly determine income constitutes the use of a Category A method of accounting.

SEC. 3. SCOPE

.01 Except as provided in section 3.02 below, this revenue procedure applies to taxpayers who (1) employ the cash receipts and disbursements method of accounting as their overall method of accounting, (2) are required to use inventories in order to clearly determine income, and (3) desire to change their overall method of accounting to the accrual method.

.02 This revenue procedure does not apply to:

(1) Financial institutions;

(2) Farmers;

(3) Cooperatives;

(4) Manufacturers and producers re-

quired to use the full absorption method for inventory costing (see section 1.471-11 of the regulations);

(5) Taxpayers who desire to change to the overall accrual method of accounting and to a special method of accounting, such as a long-term contract method or the method of accounting for prepaid subscription income provided in section 455 of the Code;

(6) Taxpayers under examination by the Service when the year or years under examination encompass the tax year in which the cash receipts and disbursements method was first employed by the taxpayer;

(7) Taxpayers who have been contacted in any manner by a representative of the Service for the purpose of scheduling an examination of their federal income tax return(s) for any year and such examination has not been completed;

(8) Taxpayers who at the time of filing Form 3115 are:

(a) Before an appeals office of the Service with respect to an examination of their federal income tax return(s) for any year, unless the taxpayer has obtained an agreement from the appeals officer that there is no objection to the proposed change in method of accounting, or

(b) Before any federal court with respect to an income tax issue arising in any year, unless the taxpayer has obtained an agreement from counsel for the Government that there is no objection to the proposed change in method of accounting;

(9) Taxpayers who are the subject of a criminal investigation or proceeding concerning, (a) directly or indirectly the taxpayer's federal tax liability for any year, or (b) the possibility of false or fraudulent statement made by the taxpayer with respect to any issue relating to its federal tax liability for any year.

.03 Taxpayers to whom this revenue procedure does not apply and who desire to change their overall method of accounting to the accrual method should file an application (Form 3115) with the Commissioner in accordance with the requirements of section 1.446-1(e)(3) of the regulations and Rev. Proc. 84-74.

SEC. 4. APPLICATION

01. *Consent.* In accordance with section 1.446-1(e)(3)(ii) of the regulations, the 180-day period is waived, and under section 1.446-1(e)(2)(i), consent is hereby granted to taxpayers who (1) employ the cash receipts and disbursements method of accounting as their overall method of accounting, and (2) are required to use inventories in order clearly to determine income, to change their overall method of accounting to the accrual method. This consent is granted for the tax year for which a taxpayer requests a change (year of change) by filing a current Form 3115 in the manner described in section 6 of this revenue procedure and by otherwise complying with the provisions of this revenue procedure. See section 5 regarding compliance with conditions of this revenue procedure.

.02 *Section 481(a) adjustment.* Section 481 of the Code prescribes the rules to be followed in computing taxable income in cases in which the taxable income of a taxpayer is computed under a method of accounting different from the method used to compute the taxable income for the preceding tax year. An adjustment is required to prevent items from being duplicated or omitted when a change in method of accounting is made. The adjustment, referred to as the "section 481(a) adjustment" is the net amount of the adjustment required by section 481(a) of the Code. The "section 481(a) adjustment" takes into account inventories, accounts receivable, accounts payable, and any other item determined necessary in order to prevent items from being duplicated or omitted. The "section 481(a) adjustment" shall be taken into account in computing taxable income in the manner provided in section 4.03 below. Rev. Proc. 79-47, 1979-2 C.B. 528, sets forth the effect of the "section 481(a) adjustment" on corporate earnings and profits. The approved change shall be considered to be a change in method of accounting initiated by the taxpayer. An example of the computation of the "section 481(a) adjustment" is as follows:

EXAMPLE 1

As of December 31, 1984, *A*, a calendar year taxpayer who uses the overall cash method of accounting, has the following items of unreported income, undeducted expenses, and deducted inventoriable costs:

Income, the right to which is fixed and the amount determinable, but that has not yet been received	$120,000
Inventory that was previously deducted	$100,000
Expenses, the liability for which is fixed, the amount determinable, and with respect to which economic performance has occurred, but that have not yet been paid	$ 30,000
Amount necessary to establish a reasonable reserve for bad debts	$ 10,000

Taxpayer *A* changes to an overall accrual method for calendar year 1985. Taxpayer *A* computes the section 481(a) adjustment in the following manner:

Income that was not included in gross income under *A*'s old method and that will never be included in gross income under *A*'s new method (accounts receivable at December 31, 1984)		$120,000
Inventory at December 31, 1984, which was deducted under *A*'s old method and will also be deducted under *A*'s new method		100,000
		220,000
Less:		
Expenses that were not deducted under *A*'s old method and that will never be deducted under *A*'s new method (accounts payable at December 31, 1984)	$30,000	
Reserve for bad debts at December 31, 1984, which was not deducted under *A*'s old method and will never be deducted under *A*'s new method	10,000	
Section 481(a) adjustment (positive)		40,000
		$180,000

.03 *Section 481 adjustment period.*

(1) The appropriate period ("adjustment period") for taking into account an adjustment, whether positive or negative, referred to in section 4.02 is generally determined as follows:

(a) For the two (2) tax years beginning after October 29, 1984, the taxpayer will be given an adjustment period determined in accordance with subdivisions (i), (ii), and (iii) below.

(i) When an entire net amount of an

adjustment is attributable to the tax year immediately preceding the year of change (first preceding year), the total net adjustment is taken into account in computing taxable income for the year of change. The amount attributable to the tax year immediately preceding the year of change is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount of the adjustment that would have been required under section 481(a) if the same change in method of accounting had been made in the preceding year.

(ii) When subdivision (i) of this section 4.03(1)(a) does not apply and 67 percent or more of the net amount of an adjustment is attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change, the highest percent attributable to the 1, 2, or 3-tax year period is to be taken into account ratably over a 3-tax year period beginning with the year of change. Any remaining balance is to be taken into account ratably over an additional period equal to the remainder of the number of tax years the taxpayer has used the method of accounting that is being changed. However, the total adjustment period shall not exceed 6 tax years. This section 4.03(1)(a)(ii) only applies if the taxpayer has used the method being changed for more than 3 tax years. If the method of accounting being changed has been used for no more than 4 tax years, 75 percent shall be substituted for 67 percent. An amount attributable to the 1, 2, or 3-tax year period is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the same change had been made at the beginning of the preceding 1, 2, or 3-tax year period.

(iii) When there is a change in method of accounting that results in a negative net adjustment under section 481(a) of the Code, the entire negative net adjustment will be taken into account in computing taxable income in the year of change.

(b) When subparagraph (a) of this section 4.03(1) does not apply and the entire net amount of an adjustment is either negative or attributable to the tax year immediately preceding the year of change, the total net adjustment is to be taken into account in computing taxable income for the year of change. The amount attributable to the tax year immediately preceding the year of change is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount of the adjustment that would have been required under section 481(a) if the same change in method of accounting had been made for such preceding year.

(c) When neither subparagraphs (a) nor (b) of this section 4.03(1) apply, the total net adjustment is to be taken into account ratably over the number of tax years (not to exceed 3) the taxpayer has used the method of accounting that is being changed.

(2) In applying section 4.03(1), if a taxpayer's books and records do not contain sufficient information to compute the section 481(a) adjustment attributable to the 1, 2, or 3 tax-year period immediately preceding the year of change, the taxpayer may reasonably estimate these amounts and attach the computations upon which the estimates are based and attach and sign the following statement to the Form 3115:

Under penalties of perjury, I hereby certify that:

(a) The books and records of [name of the taxpayer] do not contain sufficient information to permit a computation of the section 481(a) adjustment attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change as required by section 4.03(1) of Rev. Proc. 85-36.

(b) Based on the information that is contained in such records, to the best of my knowledge and belief, the entire amount of the section 481(a) adjustment for the year of change [indicate either "is" or "is not," as the case may be] attributable to the tax year immediately preceding the year of change, and 67 percent [or "75 percent", in applicable cases] or more of the section 481(a) adjustment for the year of change [indicate "is" or "is not", as the case may be] attributable to the 1-tax year period, 2 -tax year period, or 3-tax year period immediately preceding the year of change.

(3) For examples of the application of the rules prescribed in section 4.03(1) with respect to the appropriate period for taking into account the section 481(a) adjustment, see examples in section 5.14 of Rev. Proc. 84-74.

.04 *Accounts receivable.*

(1) The section 481(a) adjustment shall not include any account receivable that was worthless or partially worthless as of the last day of the year preceding the year of change. See section 1.166-3 of the regulations.

(2) If, during the adjustment period (see section 4.03), any portion of the accounts receivable included in the section 481(a) adjustment becomes worthless or partially worthless, such portion, not previously included in gross income, shall be included in income in the tax year it becomes worthless. This condition will apply regardless of whether the section 481(a) adjustment is positive or negative. This condition is illustrated by the following example.

EXAMPLE 2

A, the taxpayer in example 1, section 4.02, has determined that the section 481(a) adjustment is to be taken into account ratably over six tax years.

In 1986, $30,000 of the $120,000 accounts receivable were determined to be worthless. In 1986, *A*, will not have included in gross income $150,000 of the section 481(a) adjustment ($180,000 less $30,000 included in gross income in 1985). In 1986, *A* must include in gross income the remaining portion of the accounts receivable determined to be worthless but not previously included in gross income, of $25,000 ($30,000 less the $5,000 portion included in gross income in 1985) plus one-fifth of the remaining balance of the section 481(a) adjustment, $25,000. A total of $50,000 will be included in gross income in 1986.

Section 481(a) adjustment				$180,000
Amortization of section 481(a) adjustment				
1985				30,000
				$150,000
1986	Worthless accounts receivable	$25,000		
	1/5 of remaining section 481(a) adjustment ($150,000–25,000)	25,000	50,000	
1987			25,000	
1988			25,000	
1989			25,000	
1990			25,000	$150,000

(3) If, during the adjustment period (see section 4.03), the accounts receivable as of the last day of any tax year are reduced by more than 33 1/3 percent of the accounts receivable balance at the beginning of the year of change, the balance of the section 481(a) adjustment relating to accounts receivable not previously taken into account shall be included in income in the year the accounts receivable are so reduced. This condition will apply whether the section 481(a) adjustment is positive or negative.

.05 *Inventory.*

(1) If, during the adjustment period (see section 4.03), the inventory as of the last day of any tax year is reduced by more than 33 1/3 percent of the inventory balance at the beginning of the year of change, and remains reduced for a period of one tax year, then the remaining portion of the section 481(a) adjustment attributable to the inventory not previously deducted shall be included in income at the end of the year succeeding the year of the reduction. This condition would apply whether the section 481(a) adjustment is positive or negative. If the value of the inventory does not remain reduced for one tax year, the reduction is not considered permanent and the provisions of this paragraph do not apply. In applying this section 4.05(1), the 33 1/3 percent rule applies only to the inventory to which the section 481(a) adjustment relates. For an illustration of the kind of computations required by the above rule see the example in section 5.08(1) of Rev. Proc. 84-74.

(2) Section 4.05(1) shall not apply if the taxpayer has shown to the satisfaction of the Commissioner that such reduction is attributable to a strike, involuntary conversion, or involuntary interruption of the availability of goods. This section 4.05(2) shall apply only if the taxpayer has obtained the consent of the Commissioner. The consent must be requested no later than 90 days after the end of the tax year in which section 4.05(1) would otherwise apply.

.06 *Bad debts.* As part of the change to the accrual method, a taxpayer may adopt the reserve method for bad debts. The initial reserve for bad debts at the beginning of the year of change is included jn the section 481(a) adjustment. The amount established as the initial reserve must be considered in determining the amount of subsequent additions to such reserve, even though the entire amount of the reserve may not have been accounted for because of a spread of the section 481(a) adjustment (see section 4.03). The amount of the bad debt deduction for the year of change and for tax years thereafter will consist of a reasonable addition to the reserve for bad debts as provided by section 166(c) of the Code. In computing the reserve for bad debts, the taxpayer will not include notes receivable sold without recourse or to be sold in the immediate future without recourse. See sections 5.02(2), 5.02(3), and 5.06 of Rev. Proc. 85-8, 1985-1 C.B. 495.

.07 *Ceasing to engage in the trade or business.*

(1) With respect to a corporation:

If the corporation ceases to engage in the trade or business to which the adjustment (section 4.02) relates at any time prior to the expiration of the adjustment period referred to in section 4.03, the taxpayer shall take into account in that year the balance of the adjustment not previously taken into account in computing taxable income. See Rev. Rul. 80-39, 1980-1 C.B. 112, which holds that if a division of a corporation, for which a change in method of accounting had been granted, ceases to operate the trade or business for which the change in method was granted, the remaining portion fo the section 481(a) adjustment applicable to the business conducted by that division of the corporation must be taken into account in computing income in the year the corporation ceases to engage in that trade or business. For purposes of this condition, the taxpayer is not considered to have ceased operation of the trade or business if its assets have been acquired by another corporation in a transaction to which section 381 of the Code applies, but in such case the acquiring corporation shall continue to be subject to this revenue procedure as though it were the acquired corporation.

(2) With respect to a partnership:

In the event a partnership terminates or ceases to engage in the trade or business (within the meaning of section 708(b) of the Code) to which the adjustment (section 4.02) relates at any time prior to the expiration of the adjustment period referred to in section 4.03, the balance of the adjustment not previously taken into account in computing ordinary income shall be taken into account in that year. A partnership ceasing to engage in the trade or business includes the incorporation of the trade or business in a transaction to which section 351 of the Code applies (See Rev. Rul. 77-264, 1977-2 C.B. 187).

(3) With respect to a sole proprietor:

If the individual (sole proprietor) ceases to engage in the trade or business to which the adjustment (section 4.02) relates at any time prior to the expiration of the adjustment period referred to in section 4.03, the balance of the adjustment not previously taken into account in computing taxable income shall be taken into account in that year. A sole proprietor ceasing to engage in trade or business includes the incorporation of the trade or business in a transaction to which section 351 of the Code applies (See Rev. Rul. 77-264). A sole proprietorship does not cease to engage in that trade or business when the individual taxpayer sells a partial interest in the proprietorship and continues to be actively engaged in the management of the business that is subsequently operated as a partnership. The section 481(a) adjustment remaining at the time the partnership is formed is to be taken into account by the sole proprietor in computing his own taxable income as though there had been no change in ownership (See Rev. Rul. 66-206, 1966-2 C.B. 206).

SEC. 5. COMPLIANCE WITH CONDITIONS

Taxpayers making a change in their overall method of accounting from the cash receipts and disbursements method to the accrual method without complying with all the conditions of this revenue procedure will be deemed to have initiated the change in method of accounting without obtaining the permission of the Commissioner as required under section 446(e) of the Code.

SEC 6. MANNER OF EFFECTING THE CHANGE

.01 A taxpayer applying for a change

in method of accounting pursuant to this revenue procedure must complete and file a current Form 3115 in duplicate. The original shall be attached to the taxpayer's timely filed federal income tax return for the year of change. A copy of the Form 3115 shall be filed with the National Office addressed to the Commissioner of Internal Revenue, Attention: CC:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, no later than 270 days after the beginning of the year of change. In addition to including all of the information required on the Form 3115, the taxpayer must state: (1) that it agrees to all of the conditions of Rev. Proc. 85-36 and that it proposes to take the section 481(a) adjustment into account over the appropriate period required by section 4.03; and (2) the period over which the section 481(a) adjustment will be taken into account and the basis for such conclusion. If it is found that the taxpayer does not qualify for the change in method of accounting under this revenue procedure, the National Office or the district director will so advise the taxpayer.

.02 In order to assist in the processing of these changes in method of accounting and to insure proper handling, reference to this revenue procedure shall be made a part of the Form 3115 by either typing or legibly printing the following statement at the top of page 1 of Form 3115: "FILED UNDER REV. PROC. 85-36."

.03 The signature of the person requesting the change in method of accounting must appear in the space provided for it on the Form 3115. For example, an officer must sign on behalf of a corporation, a general partner on behalf of a partnership, a trustee on behalf of a trust, or a sole proprietor. See the signature requirements set forth in the General Instructions attached to a current Form 3115 for those who are to sign. If an agent is authorized to represent the taxpayer before the Service, to receive the original or a copy of correspondence concerning the request, or to perform any other act(s) regarding the application on behalf of the taxpayer, a power of attorney reflecting such authorization(s) must be attached to the application. Taxpayer's representatives without a power of attorney to represent the taxpayer as indicated in this subsection will not be given any information about the application.

.04 If the taxpayer is a member of an affiliated group that has elected to file a consolidated federal income tax return, a Form 3115 submitted on behalf of the taxpayer must be signed by a duly authorized officer of the common parent. See section 1.1502-77 of the regulations.

SEC. 7. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention: CC:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

SEC. 8. EFFECTIVE DATE

This revenue procedure is effective July 29, 1985, the date of its publication. Requests for change in methods that qualify under this revenue procedure and are received in the National Office after the effective date will be returned to the taxpayer. Taxpayers who have timely filed a Form 3115 with the National Office prior to the effective date of this revenue procedure may use the automatic provisions of this revenue procedure and will be notified to this effect by the National Office.

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part 1, Sections 446, 481; 1.446-1, 1.481-5.)

Rev. Proc. 85-37

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide a procedure whereby certain taxpayers may obtain expeditious consent to change their overall method of accounting from the cash receipts and disbursements method to the accrual method. Taxpayers complying with this revenue procedure will be deemed to have obtained the consent of the Commissioner of Internal Revenue to change their method of accounting.

SEC. 2. BACKGROUND

.01 Section 446(e) of the Internal Revenue Code and section 1.446-1(e) of the Income Tax Regulations state that, except as otherwise provided, in order to change a method of accounting for federal income tax purposes, a taxpayer must obtain the consent of the Commissioner. Section 1.446-1(e)(3)(i) requires that in order to obtain this consent, generally an application, Form 3115, Application for Change in Accounting Method, must be filed within 180 days after the beginning of the tax year in which the proposed change is to be made. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit taxpayers to obtain consent to change their method of accounting in accordance with section 446(e).

.02 Section 481(a) of the Code requires that those adjustments necessary to prevent amounts from being duplicated or omitted be taken into account when the taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding tax year. Section 481(c) and section 1.481-5 of the regulations provide that the adjustment required by section 481(a) may be taken into account in determining taxable income in the manner and subject to the conditions agreed to by the Commissioner and the taxpayer.

SEC. 3. SCOPE

.01 Except as provided in section 3.02 below, this revenue procedure applies to taxpayers who employ the cash receipts and disbursements method of accounting as their overall method of accounting and desire to change their overall method of accounting to the accrual method.

.02 This revenue procedure does not apply to:

(1) Financial institutions;

(2) Farmers;

(3) Cooperatives;

(4) Taxpayers required to use an inventory method of accounting in order to clearly determine income. See section 1.471-1 of the regulations and Rev. Proc. 85-36, page 434, this Bulletin;

(5) Individual taxpayers, except for activities conducted as a sole proprietor;

(6) Taxpayers who desire to change to the overall accrual method of ac-

counting and to a special method of accounting, such as a long-term contract method or the method of accounting for prepaid subscription income provided in section 455 of the Code. This exception is illustrated by the following examples.

EXAMPLE 1

X, a corporate contractor, constructs buildings pursuant to long-term contracts and employs the cash receipts and disbursements method of accounting. *X* desires to change to both the overall accrual method of accounting and to use the completed contract method for its long-term contracts.

This revenue procedure does not apply to *X* because more than a change to the overall accrual method is involved.

EXAMPLE 2

A, a dance instructor, operates as a sole proprietor and receives payments for future services. *A* uses the cash receipts and disbursements method of accounting and desires to change to both the overall accrual method of accounting and to defer recognition of payments for future services as permitted by Rev. Proc. 71-21, 1971-2 C.B. 549.

This revenue procedure does not apply to *A* because more than a change to the overall accrual method is involved.

EXAMPLE 3

B, a self-employed accountant, employs the cash receipts and disbursements method of accounting and desires to change to the accrual method of accounting.

This revenue procedure applies to *B*.

(7) Taxpayers under examination by the Service when the year or years under examination encompass the tax year in which the cash receipts and disbursements method was first employed by the taxpayer;

(8) Taxpayers who have been contacted in any manner by a representative of the Service for the purpose of scheduling an examination of their federal income tax return(s) for any year and such examination has not been completed;

(9) Taxpayers who at the time of filing Form 3115 are:

(a) Before an appeals office of the Service with respect to an examination of their federal income tax return(s) for any year, unless the taxpayer has obtained an agreement from the appeals officer that there is no objection to the proposed change in method of accounting, or

(b) Before any federal court with respect to an income tax issue arising in any tax year, unless the taxpayer has obtained an agreement from counsel for the Government that there is no objection to the proposed change in method of accounting.

(10) Taxpayers who are the subject of a criminal investigation or proceeding concerning, (a) directly or indirectly the taxpayer's federal tax liability for any year, or (b) the possibility of false or fraudulent statements made by the taxpayer with respect to any issue relating to its federal tax liability for any year.

.03 Taxpayers to whom this revenue procedure does not apply and who desire to change their overall method of accounting to the accrual method should file an application (Form 3115) with the Commissioner in accordance with the requirements of section 1.446-1(e)(3) of the regulations and Rev. Proc. 84-74, 1984-2 C.B. 736.

SEC. 4. APPLICATION

01. *Consent.* In accordance with section 1.446-1(e)(3)(ii) of the regulations, the 180-day period is waived, and, under section 1.446-1(e)(2)(i), consent is hereby granted to taxpayers using the cash receipts and disbursements method of accounting to change their overall method of accounting to the accrual method. This consent is granted for the tax year for which a taxpayer requests a change (year of change) by filing a current Form 3115 in the manner described in section 6 of this revenue procedure and by otherwise complying with the provisions of this revenue procedure. See section 5 regarding compliance with conditions of this revenue procedure.

.02 *Section 481(a) adjustment.* Section 481 of the Code prescribes the rules to be followed in computing taxable income in cases in which the taxable income of a taxpayer is computed under a method of accounting different from the method used to compute the taxable income for the preceding tax year. An adjustment is required to prevent items from being duplicated or omitted when a change in method of accounting is made. The adjustment, referred to as the "section 481(a) adjustment," is the net amount of the adjustment required by section 481(a) of the Code. The "section 481(a) adjustment" takes into account the accounts receivable, accounts payable, and any other item determined necessary in order to prevent items from being duplicated or omitted. The "section 481(a) adjustment" shall be taken into account in computing taxable income in the manner provided in section 4.03 below. Rev. Proc. 79-47, 1979-2 C.B. 528, sets forth the effect of the "section 481(a) adjustment" on corporate earnings and profits. The approved change shall be considered to be a change in method of accounting initiated by the taxpayer. Examples of the computation of the "section 481(a) adjustment" are as follows:

EXAMPLE 4

As of December 31, 1984, *D*, a calendar year taxpayer who uses the overall cash method of accounting, has the following items of unreported income and undeducted expenses:

Income, the right to which is fixed and the amount determinable, but that has not yet been received	$100,000
Expenses, the liability for which is fixed, the amount determinable, and with respect to which economic performance has occurred, but that have not yet been paid	30,000
Amount necessary to establish a reasonable reserve for bad debts	10,000

Taxpayer *D* changes to the overall accrual method for calendar year 1985. Taxpayer *D* computes the section 481(a) adjustment in the following manner:

Income that was not included in gross income under *D*'s old method and that will never be included in gross income under *D*'s new method (accounts receivable at December 31, 1984)		$100,000
Less:		
Expenses that were not deducted under *D*'s old method and that will never be deducted under *D*'s new method (accounts payable at December 31, 1984)	$30,000	
Reserve for bad debts at December 31, 1984, which was not deducted under *D*'s old method and will never be deducted under *D*'s new method	10,000	40,000
Section 481(a) adjustment (positive)		$60,000

EXAMPLE 5

As of December 31, 1984, *E*, a calendar year taxpayer who uses the overall cash method of accounting, has the following items of unreported income and undeducted expenses:

Income, the right to which is fixed and the amount determinable, but that has not yet been received	$20,000
Expenses, the liability for which is fixed and the amount determinable, and with respect to which economic performance has occurred, but that have not yet been paid	65,000

Taxpayer *E* changes to the overall accrual method for calendar year 1985. Taxpayer *E* computes the section 481(a) adjustment in the following manner:

Expenses that were not deducted under *E*'s old method and that will never be deducted under *E*'s new method (accounts payable at December 31, 1984)	$65,000
Less	
Income that was not included in gross income under *E*'s old method and that will never be included in gross income under *E*'s new method (accounts receivable at December 31, 1984)	20,000
Section 481(a) adjustment (negative)	45,000

.03 *Section 481 adjustment period.*

(1) The appropriate period ("adjustment period") for taking into account an adjustment, whether positive or negative, referred to in section 4.02 is generally determined as follows:

(a) When the entire net amount of an adjustment is attributable to the tax year immediately preceding the year of change (first preceding year), the total net adjustment is to be taken into account in computing taxable income for the year of change. The amount attributable to the tax year immediately preceding the year of change is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount of the adjustment that would have been required under section 481(a) if the same change in method of accounting had been made for such preceding year.

(b) When subparagraph (a) of this section 4.03(1) does not apply and 67 percent or more of the net amount of an adjustment is attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change, the highest percent attributable to such 1, 2, or 3-tax year period is to be taken into account ratably over a 3-year period beginning with the year of change. Any remaining balance is to be taken into account ratably over an additional period equal to the remainder of the number of tax years the taxpayer has used the method of accounting that is being changed. However, the total adjustment period shall not exceed 6 tax years. This section 4.03(1)(b) only applies if the taxpayer has used the method being changed for more than 3 tax years. If the method of accounting being changed has been used for no more than 4 tax years, 75 percent shall be substituted for 67 percent. An amount attributable to such 1, 2, or 3-tax year period is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the same change had been made at the beginning of such preceding 1, 2, or 3-tax year period.

(c) In all other situations in which subparagraphs (a) and (b) of this section 4.03(1) do not apply, the total net adjustment is to be taken into account ratably over the number of tax years (not to exceed 6) the taxpayer has used the method of accounting that is being changed.

(2) In applying section 4.03(1), if a taxpayer's books and records do not contain sufficient information to compute the section 481(a) adjustment attributable to the 1, 2, or 3-tax year immediately preceding the year of change, the taxpayer may reasonably estimate these amounts and attach the computations upon which the estimates are based and attach and sign the following statement to the Form 3115.

Under penalties of perjury, I hereby certify that:

(a) The books and records of [name of the taxpayer] do not contain sufficient information to permit a computation of the section 481(a) adjustment attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change as required by section 4.03(1) of Rev. Proc. 85-37.

(b) Based on the information that is contained in such records, to the best of my knowledge and belief, the entire amount of the section 481(a) adjustment for the year of change [indicate either "is" or "is not" as the case may be] attributable to the tax year immediately preceding the year of change, and 67 percent [or "75 percent," in applicable cases] or more of the section 481(a) adjustment for the year of change [indicate "is" or "is not," as the case may be] attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change.

(3) For examples of the application of the rules prescribed in section 4.03(1) with respect to the appropriate period for taking into account the section 481(a) adjustment, see examples in section 5.14 of Rev. Proc. 84-74.

.04 *Net Operating Loss Carryovers and Net Operating Losses.*

(1) No part of any (consolidated or separate) net operating loss carryover (NOL carryover) available at the beginning of the year of change may be used as an offset against the portion of the positive section 481(a) adjustment taken into account in the year of change. That is, the net operating loss carryover available at the beginning of the year of change may be offset only against income (other than the section 481(a) adjustment) generated in the year of change. This condition will not apply to years subsequent to year of change. Any portion of the positive section 481(a) adjustment attributable to the year of change may be offset against any net operating loss otherwise incurred in the year of change as well as any future net operating loss carryback under section 172(b) of the Code.

(2) Any portion of any net operating loss arising in the year of change or in any subsequent year in the adjustment period that is attributable to the negative section 481(a) adjustment may not be carried to those 3 tax years preceding the year of change to which section 172 of the Code otherwise would require it first to be carried.

.05 *Credit carryover*

No part of any (consolidated or separate) credit carryover available at the beginning of the year of change may be used to reduce the federal income tax

liability resulting from or attributable to, the inclusion in income of a portion of the section 481(a) adjustment in the year of change. This restriction does not apply, however, to a credit arising in the year of change or to any future credit carrybacks to the year of change.

.06 *Accounts receivable.*

(1) The section 481(a) adjustment shall not include any account receivable that was worthless or partially worthless as of the last day of the year preceding the year of change. See section 1.166-3 of the regulations.

(2) If, during the adjustment period (see section 4.03), any portion of the accounts receivable included in the section 481(a) adjustment becomes worthless or partially worthless, such portion, not previously included in gross income, shall be included in income in the tax year it becomes worthless. This condition will apply whether the section 481(a) adjustment is positive or negative. This condition is illustrated by the following example.

EXAMPLE 6

F, a calendar year taxpayer, employs this revenue procedure to change to the overall accrual method of accounting in 1985. The section 481(a) adjustment (positive) of $60,000 was comprised of $120,000, income (accounts receivable as of December 31, 1984) less $60,000, expenses (accounts payable as of December 31, 1984). It is determined that the section 481(a) adjustment is to be taken into account ratably over six tax years.

In 1987, $30,000 of the $120,000 accounts receivable were determined to be totally worthless. In 1987, *F* will not have included in gross income $40,000 of the section 481(a) adjustment ($60,000 less $10,000 included in gross income in both 1985 and 1986). In 1987, *F* must include in gross income the remaining portion of the accounts receivable determined to be totally worthless but not previously included in gross income, of $20,000 ($30,000) less the $5,000 portion included in gross income in both 1985 and 1986), plus one-fourth of the remaining balance of the section 481(a) adjustment, $20,000. A total of $25,000 will be included in gross income in 1987.

	Section 481(a) adjustment			
Amortization of section 481(a) adjustment				$60,000
1985				
1986			$10,000	
			10,000	20,000
				$40,000
1987	Worthless accounts receivable	$20,000		
	1/4 of remaining section 481(a) adjustment ($40,000-20,000)			
		5,000	25,000	
1988			5,000	
1989			5,000	
1990			5,000	40,000

(3) If, during the adjustment period (see section 4.03), the accounts receivable as of the last day of any tax year are reduced by more than 33 1/3 percent of the accounts receivable balance at the beginning of the year of change, the balance of the section 481(a) adjustment relating to accounts receivable not previously taken into account shall be included in income in the year the accounts receivable are so reduced. This condition will apply whether the section 481(a) adjustment is positive or negative.

.07 *Bad Debts.* As part of the change to the accrual method, a taxpayer may adopt the reserve method for bad debts. The initial reserve for bad debts at the beginning of the year of change is included in the section 481(a) adjustment. The amount established as the initial reserve must be considered in determining the amount of subsequent additions to such reserve, even though the entire amount of the reserve may not have been accounted for because of the spread of a section 481(a) adjustment (see section 4.03). The amount of the bad debt deduction for the year of change and for tax years thereafter will consist of a reasonable addition to the reserve for bad debts as provided by section 166(c) of the Code. In computing the reserve for bad debts, the taxpayer will not include notes receivable sold without recourse or to be sold in the immediate future without recourse. See sections 5.02(2), 5.02(3), and 5.06 of Rev. Proc. 85-8, 1985-1 C.B. 495.

.08 *Ceasing to engage in the trade or business.*

(1) With respect to a corporation:

If the corporation ceases to engage in the trade or business to which the adjustment (section 4.02) relates at any time prior to the expiration of the adjustment period referred to in section 4.03, the taxpayer shall take into account in that year the balance of the adjustment not previously taken into account in computing taxable income. See Rev. Rul. 80-39, 1980-1 C.B. 112, which holds that if a division of a corporation for which a change in method of accounting had been granted ceases to operate the trade or business for which the change in method was granted, the remaining section 481(a) adjustment applicable to the business conducted by that division of the corporation must be taken into account in computing income in the year the corporation ceases to engage in that trade or business. For purposes of this condition, the taxpayer is not considered to have ceased operation of the trade or business if its assets have been acquired by another corporation in a transaction to which section 381 of the Code applies, but in that case the acquiring corporation shall continue to be subject to this revenue procedure as though it were the acquired corporation.

(2) With respect to a partnership:

In the event a partnership terminates or ceases to engage in the trade or business (within the meaning of section 708 of the Code) to which the adjustment (section 4.02) relates at any time prior to the expiration of the adjustment period referred to in section 4.03, the balance of the adjustment not previously taken into account in computing ordinary income shall be taken into account in that year. A partnership ceasing to engage in the trade or business includes the incorporation of the trade or business in a transaction to which section 351 of the Code applies. (See Rev. Rul. 77-264, 1977-2 C.B. 187.)

(3) With respect to a sole proprietor:

If the individual (sole proprietor) ceases to engage in the trade or business to which the adjustment (section 4.02) relates at any time prior to the expiration of the adjustment period referred to in section 4.03, the balance of the adjustment not previously taken into account in computing taxable income shall be taken into account in that year. A sole proprietor ceasing to engage in trade or business includes the incorporation of the trade or business in a transaction to which section 351 of the Code applies. (See Rev. Rul.

77-264.) A sole proprietorship does not cease to engage in that trade or business when the individual taxpayer sells a partial interest in the proprietorship and continues to be actively engaged in the management of the business that is subsequently operated as a partnership. The section 481(a) adjustment remaining at the time the partnership is formed is to be taken into account by the sole proprietor in computing his own taxable income as though there had been no change in ownership (See Rev. Rul. 66-206, 1966-2 C.B. 206).

SEC. 5. COMPLIANCE WITH CONDITIONS

Taxpayers making a change in their overall method of accounting from the cash receipts and disbursements method to the accrual method without complying with all the conditions of this revenue procedure will be deemed to have initiated the change in method of accounting without obtaining the permission of the Commissioner as required under section 446(e) of the Code.

SEC. 6. MANNER OF EFFECTING THE CHANGE

.01 A taxpayer applying for a change in method of accounting pursuant to this revenue procedure must complete and file a current Form 3115 in duplicate. The original shall be attached to the taxpayer's timely filed federal income tax return for the year of change. A copy of the Form 3115 shall be filed with the National Office addressed to the Commissioner of Internal Revenue, Attention: CC:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, no later than 270 days after the beginning of the year of change. In addition to including all of the information required on the Form 3115, the taxpayer must state: (1) that it agrees to all of the conditions of Rev. Proc. 85-37 and that it proposes to take the section 481(a) adjustment into account over the appropriate period required by section 4.03; and (2) the period over which the section 481(a) adjustment will be taken into account and the basis for such conclusion. If it is found that the taxpayer does not qualify for the change in method of accounting under this revenue procedure, the National Office or the district director will so advise the taxpayer.

.02 In order to assist in the processing of these changes in method of accounting and to insure proper handling, reference to this revenue procedure shall be made a part of the Form 3115 by either typing or legibly printing the following statement at the top of page 1 of Form 3115: "FILED UNDER REV. PROC. 85-37."

.03 The signature of the person requesting the change in method of accounting must appear in the space provided for it on the Form 3115. For example, an officer must sign on behalf of a corporation, a general partner on behalf of a partnership, a trustee on behalf of a trust, or a sole proprietor See the signature requirements set forth in the General Instructions attached to a current Form 3115 for those who are to sign. If an agent is authorized to represent the taxpayer before the Service, to receive the original or a copy of correspondence concerning the request, or to perform any other act(s) regarding the application on behalf of the taxpayer, a power of attorney reflecting such authorization(s) must be attached to the application. Taxpayer's representatives without a power of attorney to represent the taxpayer as indicated in this subsection will not be given any information about the application.

.04 If the taxpayer is a member of an affiliated group that has elected to file a consolidated federal income tax return, a Form 3115 submitted on behalf of the taxpayer must be signed by a duly authorized officer of the common parent. See section 1.1502-77 of the regulations.

SEC. 7. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention: CC:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

SEC. 8. EFFECTIVE DATE

This revenue procedure is effective July 29, 1985, the date of its publication. Requests for change in methods of accounting that qualify under this revenue procedure and are received in the National Office after the effective date will be returned to the taxpayer. Taxpayers who have timely filed a Form 3115 with the National Office prior to the effective date of this revenue procedure may use the automatic provisions of this revenue procedure and will be notified to this effect by the National Office.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 103; 1.103-14.)

Rev. Proc. 85-38

SECTION 1. PURPOSE

The purpose of this revenue procedure is to set forth guidelines under which the Internal Revenue Service will issue an advance ruling that a proper method of valuation will be used for the acquired obligations in a reasonably required reserve or replacement fund described in section 103(c)(4)(B) of the Internal Revenue Code and Section 1.103-14(d) of the Income Tax Regulations.

SEC. 2. BACKGROUND

.01 Section 103(a)(1) of the Code provides that gross income does not include interest on the obligations of a state or a political subdivision of a state. Section 103(c)(1) provides that, with certain exceptions, any arbitrage bond will not be treated as an obligation described in section 103(a)(1). An arbitrage bond is any obligation that is part of an issue all or a major portion (more than 15 percent) of the proceeds of which are reasonably expected to be used to acquire securities that will produce a yield over the term of the issue that is materially higher than the yield on such issue.

.02 Section 103(c)(4)(B) of the Code provides that an obligation shall not be treated as an arbitrage bond solely by reason of the fact that an amount of the proceeds of the issue of which such obligation is a part may be invested in securities or other obligations that are part of a reasonably required reserve or replacement fund. The amount of the bond proceeds invested in securities or other obligations that is part of a reasonably required reserve or replacement fund shall not exceed 15 percent of the proceeds of the issue unless the issuer establishes that a higher amount is necessary.

.03 Section 1.103-14(d)(1) of the

regulations provides that, under section 103(c)(4)(B), an obligation shall not be treated as an arbitrage bond solely by reason of the fact that a portion of any proceeds of the issue of which such obligation is a part may be invested in materially higher yield acquired obligations that are part of a reasonably required reserve or replacement fund.

.04 Section 1.103-14(d)(2) of the regulations provides that if an amount in excess of the amount provided in section 1.103-14(d)(1) (including, for example, an amount in excess of 15 percent of the original face amount of the issue) is invested in a reserve or replacement fund, such excess will be considered to be invested in a reasonably required reserve or replacement fund if (i) the issuer applies for a ruling that the specified reserve or replacement fund is necessary, and (ii) a ruling to that effect is subsequently issued to the governmental unit.

.05 A reserve or replacement fund ordinarily will be considered to be "reasonably required" within the meaning of section 103(c)(4)(B) of the Code if such fund does not exceed the lesser of (1) maximum annual debt service, or (2) one and one-quarter times the average annual debt service. See Rev. Proc. 84-26, 1984-1 C.B. 468.

.06 The issuer of municipal obligations may provide in the bond indenture or a similar document that the value of the acquired obligations in the reserve or replacement fund must not be permitted to fall below the amount determined to be reasonably required. Therefore, when the acquired obligations in the reserve or replacement fund decrease in value below the amount determined to be reasonably required, the issuer is required to transfer securities to the fund. The issuer, or other person with a material financial interest in the municipal obligations, may want to request a ruling from the Service that the method of valuing the acquired obligations in the reasonably required reserve or replacement fund will be proper.

SEC. 3. APPLICATION

A ruling ordinarily will be issued by the Service that a method of valuing the acquired obligations in a reasonably required reserve or replacement fund will be proper if the following conditions are met:

.01 The issuer of municipal obligations must value the acquired obligations in the reasonably required reserve or replacement fund under either the "cost" or the "fair market value" method of valuation. The issuer must be consistent in the use of the method of valuation adopted.

.02 If the acquired obligations in the reserve or replacement fund are valued at cost but the actual total fair market value of such acquired obligations is less than the amount of the reserve or replacement fund that could be determined to be reasonably required under section 103(c)(4)(B) of the Code, the issuer may not add securities in an amount necessary to increase the reserve or replacement fund to a reasonably required amount calculated on the fair market value method. If the acquired obligations in the reserve or replacement fund are valued at cost but the total fair market value of such acquired obligations is more than the amount of the reserve or replacement fund that could be determined to be reasonably required under section 103(c)(4)(B), the issuer need not reduce the acquired obligations or restrict the yield on the acquired obligations.

.03 If the acquired obligations in the reserve or replacement fund are valued at fair market value and the total value of such acquired obligations is less than the amount of the reserve or replacement fund determined to be reasonably required under section 103(c)(4)(B) of the Code, the issuer may add securities in an amount necessary to restore the reserve or replacement fund to its reasonably required amount.

.04 If the acquired obligations in the reserve or replacement fund are valued at fair market value and the total value of such acquired obligations is more than the amount of the reserve of replacement fund determined to be reasonably required under section 103(c)(4)(B) of the Code, the issuer must reduce the amount of acquired obligations by an amount equal to the excess of the fair market value of the acquired obligations over the amount of the reserve or replacement fund determined to be reasonably required under section 103(c)(4)(B) or restrict a yield on the same amount of acquired obligations in accordance with section 1.103-13(b)(5) of the regulations.

.05 If an issuer uses the fair market value method of valuation, the valuation of the acquired obligations in the reserve or replacement fund must be accomplished on an annual basis unless the bond indenture requires a more frequent valuation.

.06 The requester must comply with the requirements of Rev. Proc. 84-48, 1984-1 C.B. 547, Rev. Proc. 84-49, 1984-1 C.B. 548, and Rev. Proc. 84-50, 1984-1 C.B. 550, whichever are applicable, and any other applicable revenue procedures.

SEC. 4. INQUIRIES

Inquiries with respect to this revenue procedure should refer to its number and should be addressed to the Commissioner of Internal Revneue, Attention: CC:IND:S, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

SEC. 5. EFFECTIVE DATE

This revenue procedure shall be effective with respect to advance rulings regarding the method of valuation of acquired obligations in reasonably required reserve or replacement funds for municipal obligations to be sold after July 29, 1985.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 103A; 6a.103A-2.)

Rev. Proc. 85-39[1]

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide issuers of "mortgage subsidy bonds," as defined in section 103A(b)(1) of the Internal Revenue Code, with a list of the "state ceiling" safe harbor limitations to assist the issuers in determining whether the bonds will be treated as tax-exempt obligations under section 103(a)(1) or (2).

SEC. 2. BACKGROUND

.01 Section 103(a) of the Code provides that gross income does not include interest on (1) the obligations of a state, a territory, or a possession of the United States, or any political sub-

[1]Also released as News Release IR-85-67, dated July 15, 1985

division of any of the foregoing, or of the District of Columbia, and (2) qualified scholarship funding bonds.

.02 Section 103A was added to the Code by the Mortgage Subsidy Bond Tax Act of 1980, 1980–2 C.B. 512. Section 103A was amended by Pub. L. 96-595, 1980-2 C.B. 647, the Tax Equity and Fiscal Responsibility Act of 1982, 1982-2 C.B. 462, and the Tax Reform Act of 1984, 1984-3 (Vol. 1) C.B. 1. Section 103A(a) provides that, with certain exceptions, any mortgage subsidy bond will be treated as an obligation not described in section 103(a)(1) or (2). A mortgage subsidy bond is an obligation that is issued as part of an issue a significant portion of the proceeds of which is to be used directly or indirectly to provide mortgages on owner-occupied residences.

.03 Section 103A(b)(2)(A) of the Code provides that any "qualified mortgage bond" will not be treated as a mortgage subsidy bond. A qualified mortgage bond is an obligation issued as part of a "qualified mortgage issue." An issue by a state or political subdivision of a state of one or more obligations is a qualified mortgage issue if (1) all proceeds of the issue (exclusive of issuance costs and a reasonably required reserve) are to be used to finance owner-occupied residences, and (2) the issue meets the requirements of subsections (d), (e), (f), (h), (i), and (j) of section 103A.

.04 In general, an issue meets the requirements of subsection (g) of section 103A of the Code if the aggregate amount of bonds issued under that subsection, when added to the aggregate amount of qualified mortgage bonds previously issued by the issuing authority during the calendar year, does not exceed the authority's market limitation for such calendar year. Each issuer's market limitation is the issuer's proportionate share of the state ceiling limitation. The state proportionate share of the state ceiling limitation. The state ceiling limitation applicable to any state for any calendar year is the greater of (A) 9 percent of the average annual aggregate principal amount of mortgages executed during the immediately preceding 3 calendar years for single-family, owner-occupied residences located within the jurisdiction of the state, or (B) $200,000,000. A state or local government may elect to exchange all or part of their qualified mortgage bond authority for authority to issue mortgage credit certificates. Section 103A(g)(8) provides that the applicable limit of any issuing authority for any calendar year shall be reduced by the sum of the amount of qualified mortgage bonds that such authority elects not to issue under section 25(c)(2)(A) during such year, plus the amount of any reduction in such ceiling under section 25(f).

.05 Temporary Income Tax Regulations relating to the tax-exempt status of certain mortgage subsidy bonds under section 103A of the Code were published in the Federal Register dated July 1, 1981 (46 FR 34311), 1981-2 C.B. 25, and were amended November 10, 1981 (46 FR 55513), 1981-2 C.B. 40; May 24, 1982 (47 FR 22360), 1982-1 C.B. 23; June 8, 1982 (47 FR 24701), 1982-2 C.B. 51; June 29, 1982 (47 FR 28094), 1982-2 C.B. 52; and December 12, 1984 (49 FR 48292), 1985-1 C.B. 49. Section 6a.103A-2(g)(6)(iii) of the temporary regulations provides that an issuer may rely upon the state ceiling safe harbor limitation published by the Department of the Treasury. An issuer may use a limitation different from the published safe harbor limitation if the different limitation is based on more accurate and comprehensive data.

.06 The state ceiling safe harbor limitations for 1984 were released by News Release IR-84-78 on July 18, 1984, and were published in Rev. Proc. 84-53, 1984-2 C.B. 488. Announcement 84-133, 1984-53 I.R.B. 28, announced that issuers of mortgage subsidy bonds to be issued in 1985 may continue to rely on the 1984 state ceiling safe harbor limitations published in Rev. Proc. 84-53 until the 1985 state ceiling safe harbor limitations are published.

.07 Section 103(m)(1) of the Code provides that obligations the interest on which is exempt under provisions outside the Internal Revenue Code must satisfy the appropriate requirements under sections 103 and 103A if issued after December 31, 1983. For purposes of applying such requirements, a possession of the United States shall be treated as a state.

SEC. 3. APPLICATION

.01 Issuers of qualified mortgage bonds may rely on the 1985 state ceiling safe harbor limitations contained in this revenue procedure. The safe harbor limitations are based on data and procedures that are employed in the Department of Housing and Urban Development (HUD) coordinated surveys of mortgage lending activity for 1-4 family residences. The estimates of mortgage volume for 1-4 family dwellings in each state are adjusted from a special tabulation of the HUD sponsored Annual Housing Survey to reflect only the amount of mortgages originated that were secured by owner-occupied residences.

.02 The mortgage loan originations secured by owner-occupied residences during 1982, 1983, and 1984 and the 1985 state ceiling safe harbor limitations for each state, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands, are listed below (dollars in millions).

State	Gross Mortgage Originations For Owner-Occupied Homes			Three-Year Total	Three-Year Average	Nine Percent of Average	1985 State Ceiling Safe Harbor Limitations
	1982	1983	1984				
Alabama	485	1,479	1,498	3,462	1,154	104	200
Alaska	392	693	702	1,787	*596	54	200
Arizona	1,689	3,594	3,564	8,847	2,949	265	265

Arkansas	974	1,139	1,095	3,208	1,069	96	200
California	11,560	34,014	36,276	81,850	27,283	2,455	2,455
Colorado	2,478	5,105	4,899	12,482	4,161	374	374
Connecticut	1,447	3,152	2,909	7,508	2,503	225	225
Delaware	152	381	350	883	294	26	200
District of Columbia	432	576	560	1,568	523	47	200
Florida	4,140	9,552	9,791	23,483	7,828	705	705
Georgia	1,311	3,341	3,572	8,224	2,741	247	247
Hawaii	496	1,188	1,265	2,949	983	88	200
Idaho	196	523	376	1,095	365	33	200
Illinois	3,493	7,570	6,105	17,168	5,723	515	515
Indiana	1,351	2,642	2,338	6,331	2,110	190	200
Iowa	575	1,144	926	2,645	882	79	200
Kansas	634	1,551	1,294	3,479	1,160	104	200
Kentucky	621	1,272	1,124	3,017	1,006	91	200
Louisiana	1,065	2,459	2,205	5,729	1,910	172	200
Maine	312	567	588	1,467	489	44	200
Maryland	2,162	4,587	4,564	11,313	3,771	339	339
Massachusetts	1,322	3,572	3,886	8,780	2,927	263	263
Michigan	2,419	3,686	3,358	9,463	3,154	284	284
Minnesota	1,435	2,656	2,277	6,368	2,123	191	200
Mississippi	359	868	1,168	2,395	798	72	200
Missouri	1,041	2,731	2,553	6,325	2,108	190	200
Montana	225	566	460	1,251	417	38	200
Nebraska	445	1,045	648	2,138	713	64	200
Nevada	653	1,381	1,130	3,164	1,055	95	200
New Hampshire	298	866	820	1,984	661	59	200
New Jersey	3,033	5,239	6,560	14,832	4,944	445	445
New Mexico	417	1,038	953	2,408	803	72	200
New York	3,986	7,378	9,431	20,795	6,932	624	624
North Carolina	1,911	3,419	3,233	8,563	2,854	257	257
North Dakota	239	451	338	1,028	343	31	200
Ohio	2,755	5,851	4,987	13,593	4,531	408	408
Oklahoma	1,315	2,771	1,938	6,024	2,008	181	200
Oregon	544	1,092	810	2,446	815	73	200
Pennsylvania	3,132	5,496	5,753	14,381	4,794	431	431
Rhode Island	303	445	443	1,191	397	36	200
South Carolinia	852	1,593	1,566	4,011	1,337	120	200
South Dakota	128	304	283	715	238	21	200
Tennessee	1,093	2,547	2,331	5,971	1,990	179	200
Texas	10,279	15,669	13,373	39,321	13,107	1,180	1,180
Utah	484	1,490	1,324	3,298	1,099	99	200
Vermont	211	284	266	761	254	23	200
Virginia	2,812	6,583	6,378	15,773	5,258	473	473
Washington	1,480	3,838	3,287	8,605	2,868	258	258
West Virginia	368	596	561	1,525	508	46	200
Wisconsin	1,533	3,156	2,307	6,996	2,332	210	210
Wyoming	285	523	410	1,218	406	37	200
Guam	0	27	30	57	19	2	200
Puerto Rico	454	388	478	1,320	440	40	200
Virgin Islands	3	6	8	17	6	1	200

26 CFR 601.602: Tax forms and instructions.

Rev. Proc. 85-40

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NOTE: THIS REVENUE PROCEDURE MAY ONLY BE USED TO PREPARE MAGNETIC TAPE SUBMISSIONS FOR TAX YEAR 1985. UPDATED COPIES ARE PUBLISHED EACH YEAR. PLEASE READ THIS PUBLICATION CAREFULLY; **YOU MAY BE SUBJECT TO PENALTIES IF YOU FAIL TO FOLLOW THE INSTRUCTIONS IN THIS REVENUE PROCEDURE.** THESE INCLUDE PENALTIES OF $50 PER DOCUMENT FOR EACH DOCUMENT SUBMITTED WITHOUT A TAXPAYER IDENTIFICATION NUMBER (TIN) OR WITH AN INCORRECT TIN, AND FOR EACH DOCUMENT NOT SUBMITTED ON MAGNETIC MEDIA IF YOU ARE REQUIRED TO FILE THIS WAY. THE MAXIMUM PENALTY IS $50,000 (PAYERS OF INTEREST AND DIVIDENDS ARE NOT SUBJECT TO THIS MAXIMUM).

PART A.—GENERAL

SECTION 1. PURPOSE

.01 The purpose of this revenue procedure is to provide the requirements and conditions for filing information return Forms 1098, 1099, 5498, and W-2G on magnetic tape. *THIS REVENUE PROCEDURE IS TO BE USED FOR THE PREPARATION OF TAX YEAR 1985 INFORMATION RETURNS ONLY.* THIS PROCEDURE IS UPDATED YEARLY TO REFLECT NECESSARY CHANGES. PLEASE READ THIS PUBLICATION CAREFULLY. Specifications for filing the following forms are contained in this procedure:

(a) Form 1098, Mortgage Interest Statement.

(b) Form 1099-A, Information Return for Acquisition or Abandonment of Secured Property.

(c) Form 1099-B, Statement for Recipients of Proceeds from Broker and Barter Exchange Transactions.

(d) Form 1099-DIV, Statement for Recipients of Dividends and Distributions.

(e) Form 1099-G, Statement for Recipients of Certain Government Payments.

(f) Form 1099-INT, Statement for Recipients of Interest Income.

(g) Form 1099-MISC, Statement for Recipients of Miscellaneous Income.

(h) Form 1099-OID, Statement for Recipients of Original Issue Discount.

(i) Form 1099-PATR, Statement for Recipients (Patrons) of Taxable Distributions Received From Cooperatives.

(j) Form 1099-R, Statement for Recipients of Total Distributions from Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, etc.

(k) Form 5498, Individual Retirement Arrangement Information.

(l) Form W-2G, Statement for Recipients of Certain Gambling Winnings.

.02 This procedure also provides the requirements and specifications for magnetic tape filing under the Combined Federal/State Filing Program. Refer to Part A, Sec. 14.

.03 The following revenue procedures and publications provide more detailed filing procedures for certain information returns, payer identification, transfer agents and paper substitute specifications, respectively.

(a) 1985 "Instructions for Form 1099 Series, 1098, 5498, and 1096", provide further information on filing returns with the Internal Revenue Service (IRS). These instructions are available at local IRS offices.

(b) Rev. Proc. 84-24, 1984-1 C.B. 465, regarding preparation of transmittal documents for information returns.

(c) Rev. Proc. 84-33, 1984-1 C.B. 502, regarding the optional method for agents to report and deposit backup withholding.

(d) Publication 1179, Requirements for Reproducing Paper Substitutes of Forms 1096, 1099 series, 5498, W-2G and W-3G. A supplement will be issued to include instructions for substitutes of Form 1098, Mortgage Interest Statement.

.04 This procedure supersedes the following revenue procedure: Rev. Proc. 84-61, 1984-2 C.B. 505, also published in Publication 1220 Rev. (9-84), Requirements and Conditions for Filing Information Returns in the Forms 1099, 5498, and W-2G Series on Magnetic Tape.

.05 Refer to Part A, Sec. 15 for definitions of terms used in this publication.

SEC. 2 BACKGROUND—PRIOR YEAR CHANGES (TAX YEAR 1984)

.01 This section contains a *review* of the changes described in the revenue procedure last year. *Please* insure that the necessary reprogramming was accomplished in order to comply with last year's changes as these changes will still be necessary in the programming for the current year.

.02 The following were general changes.

(a) Procedures for applying for waivers for undue hardship were added.

(b) An explanation of penalties was added.

(c) Reports from different branches for one payer were consolidated under one Payer/Transmitter "A" Record for each type of information return. For example, all like Form 1099-INT documents must be sorted together under

one Payer/Transmitter "A" Record, followed by the appropriate Payee "B" Records and one End of Payer "C" Record.

(d) The explanation of Taxpayer Indentification Numbers (TINs) was rewritten to clarify changes concerning backup withholding and due diligence requirements.

(e) Changes were made to the requirements concerning the paper copy of the information return furnished to the payee.

(f) A definition for "Transfer Agent" was added.

(g) A list of valid U.S. Postal Service State Abbreviations was added to aid in developing the State Code portion of Name Line fields.

(h) The size of the block which IRS programs can accept was increased to 10,000 tape positions.

(i) Records may not span blocks.

(j) Trailer labels EOV1 and EOV2 were added as standard trailer labels IRS programs can process.

.03 The following changes were made to the Payer/Transmitter "A" Record.

(a) Header label UHL1 was added as one of the standard labels IRS programs can process.

(b) Amount Indicator "2" was added for Form 5498.

(c) "Type of Return" and "Amount Indicators" were added for Form W-2G.

(d) The codes for "Type of Payer" and "Payee 'B' Record Surname Indicator" fields should have been deleted from your programs. However, the positions in the record *should not* have been deleted. Fill these positions with blanks.

(e) The "Second Payer Name" field was shortened from 40 characters to 39 characters. The contents of the "Second Payer Name" field, as well as the contents of the "Payer Shipping Address" and the "Payer City, State and ZIP Code" fields, are dependent upon the value of the "Transfer Agent Indicator".

(f) A "Transfer Agent Indicator" was added following the "Second Payer Name" field. The contents of this field let IRS programs know if the information in "Second Payer Name", "Payer Shipping Address" and "Payer City, State and ZIP Code" pertains to the Payer or to the Transfer Agent.

(g) The name of "Payer Mailing Address" was changed to "Payer Shipping Address". Beginning with Tax Year 1984 returns, IRS notified payers of any information returns not containing valid TINs. This notification includes a payee notice for each such information return. Therefore, we must have an address capable of accepting volume mail.

.04 The following changes were made to the Payee "B" Record.

(a) The meaning of the "Document Specific Code" for Form 1099-G was expanded.

(b) The use of the "Document Specific Code" was increased to include 'Type of Wager for Form W-2G.

(c) PLEASE NOTE: If any one Payment Amount Field exceeds "9999999999" (dollars and cents), as many SEPARATE Payee "B" Records as necessary to contain the total MUST be submitted for the Payee. Example: the total money amount to be reported for Payee ABC is $250,371,491.87. Three Payee "B" Records will have to be submitted for Payee ABC to contain the entire total amount. (DO NOT enter dollar signs, commas, or decimal points in the Payment Amount fields.)

(d) New field definitions specific to Form W-2G for positions 293-360 were added.

SEC. 3. NATURE OF CHANGES—CURRENT YEAR (TAX YEAR 1985)

.01 DUE TO *NUMEROUS* LEGISLATIVE AND FORMS CHANGES BETWEEN TAX YEARS 1984 AND 1985, CHANGES HAVE *NOT* BEEN LISTED INDIVIDUALLY UNDER THIS SECTION. THIS ENTIRE PUBLICATION HAS BEEN REVISED. REVIEW THIS REVENUE PROCEDURE IN ITS *ENTIRETY*.

SEC. 4. WAGE AND PENSION INFORMATION FILED WITH SSA

.01 Section 8(b), Public Law 94-202, 1976-1 C.B. 503, enacted in January 1976, authorized the combined reporting of FICA detailed information in one consolidated annual W-2 (Copy A) to the Federal government. AS A RESULT, FORMS W-2 AND W-2P ARE TO BE FILED WITH THE SOCIAL SECURITY ADMINISTRATION (SSA), NOT WITH THE INTERNAL REVENUE SERVICE.

.02 SSA will accept magnetic media filing of Forms W-2 and W-2P and has issued the following concerning this: TIB-4a, "*Magnetic Tape Reporting*, Submitting FICA Wage and Tax Data to the Social Security Administration"; TIB-4b, "*Magnetic Tape Reporting*, Submitting Annuity, Pension, Retired Pay or IRA Payment to the Social Security Administration"; and TIB-4c, "*Diskette Reporting*, Submitting FICA Wage and Tax Data to the Social Security Administration". Applications for filing Forms W-2 and W-2P on magnetic media appear in TIBs-4a, 4b, and 4c.

.03 Copies of Social Security Administration publications TIB-4a, 4b, and 4c are available from any local Social Security Administration office or the SSA Regional Magnetic Media Coordinators.

SEC. 5. APPLICATION FOR MAGNETIC MEDIA REPORTING AND REQUESTS FOR UNDUE HARDSHIP WAIVERS

.01 For purposes of this revenue procedure, the *PAYER* is the organization making the payments and the *TRANSMITTER* is the organization preparing the magnetic tape file. The payer and transmitter may be the same organization. Payers or their transmitters are required to complete Form 4419, Application for Magnetic Media Reporting of Information Returns. A copy of this form, for your use, can be found at the end of this publication. Requests for additional information or forms related to magnetic media processing should be addressed to the Magnetic Media Coordinator at the appropriate service center or the National Computer Center.

On January 1, 1985, the National Computer Center assumed responsibility for the magnetic media processing previously handled by the Philadelphia, Kansas City, and Austin Service Centers. Beginning January 1, 1986, magnetic media processing for *ALL* service centers will be centralized at the National Computer Center. Addresses are listed in Part A, Sec. 13 of this revenue procedure.

.02 Applications should be filed with the National Computer Center or

the appropriate service center 90 days before the due date of the return. IRS will act on an application and notify the applicant, in writing, of authorization to file. A five character *Transmitter Control Code* will be assigned and included in an acknowledgement letter within 30 days of receipt of the application. Magnetic tape returns may not be filed with IRS until the application has been approved. Do not enter blanks in the "A" Record Transmitter Control Code field; enter the five character Transmitter Control Code which is assigned to you by IRS after you have filed an application and it has been approved.

.03 After you have received approval to file on magnetic media, you do not need to reapply each year *UNLESS*:

(a) there are hardware or software changes that would affect the characteristics of the magnetic media submission (e.g., changing from diskette to tape filing or vice versa) or,

(b) you discontinue filing on magnetic media for a year (your five character Transmitter Control Code may be reassigned).

If either of these conditions applies to you, you should contact your coordinator for clarification. In *ALL* correspondence, refer to your current five character Transmitter Control Code to assist the coordinator in locating your files.

.04 IRS will assist new filers with their initial magnetic tape submission by reviewing "*test*" files submitted in advance of the filing season. Approved payers or transmitters should submit "*test*" files with the Magnetic Media Coordinator at the appropriate service center or the National Computer Center. You *MUST* submit a "*test*" file in order to participate in the Combined Federal/State Program; however, you are encouraged to submit "*test*" files if you are a new filer on magnetic media. As a guideline, IRS prefers that all "*test*" files be submitted between September and December. Refer to Part A, Sec. 13 for addresses. Do not submit "*test*" tapes after January 1. If you are unable to submit your "*test*" file by the end of December, you may *only* send a sample hardcopy printout or tape dump to the National Computer Center which shows a sample of each record (A, B, C, K and F) *used*. Clearly mark the hardcopy printout or tape dump as "TEST DATA", and include identification information such as name, address and telephone number of someone familiar with the "*test*" print or tape dump who may be contacted to discuss its acceptability. After January 1, 1986, submit the "*test*" print or tape dump showing a sample of each record to the National Computer Center only.

.05 If your magnetic media files have been prepared for you in the past by a service agency, and you now have computer equipment compatible with that of IRS and wish to prepare your own files, you must request your own five character Transmitter Control Code by filing an application, Form 4419, as described above.

.06 If you as an individual or organization are an approved filer on magnetic media and you change your name or the name of your organization, please notify the National Computer Center or service center Magnetic Media Coordinator so that your file may be updated to reflect the proper name.

.07 In accordance with section 1.6041-7(b) of the Income Tax Regulations, payments to providers of medical and health care services from separate departments of a health care carrier may be reported as separate returns on magnetic media. In this case, the headquarters office will be considered to be the transmitter, and the individual departments of the company filing reports will be considered to be payers. A *single* application form covering *all* the departments which will be filing on magnetic tape should be submitted. One five character Transmitter Control Code may be used for all departments.

.08 Section 1.6045-1(1) of the Income Tax Regulations requires brokers and barter exchanges to use magnetic media in reporting all Form 1099-B data to the IRS. Generally, *NEW* brokers and *NEW* barter exchanges may request an undue hardship exemption by filing an application, by the end of the second month following the month in which they became a broker or barter exchange, with the National Computer Center or service center Magnetic Media Coordinator.

.09 *All* requests for undue hardship exemptions should be submitted at least 90 days before the due date of the return, except as stated in Sec. 5.08 above.

.10 The requirements to receive a waiver from filing *required* information returns on magnetic media for tax year 1985 are more stringent than they were for tax year 1984. Filers must submit a *written* statement requesting an undue hardship waiver from magnetic media filing for a specific period of time, not to exceed one tax year. If the filer requires a waiver for a longer period of time, the filer must reapply at the appropriate time each year (90 days before the due date of the return). Filers may not apply for a waiver for more than one tax year at a time. The written statement *must* contain the following identification information:

(a) The filer's name and address.

(b) The filer's Taxpayer Identification Number (SSN or EIN).

(c) The period for which the waiver is requested: Tax Year 1985.

(d) The name and telephone number of a person to contact who is familiar with the information contained in the waiver request.

(e) The type of returns and expected volume of each form.

(f) The reason for the request.

(g) The estimated cost for filing the returns on paper, or magnetic media if *you* prepare the files, and on magnetic media using the services of an agency who will charge you for this service. IF YOU EXPECT TO FILE OVER 500 RETURNS, YOU *MUST* SUBMIT A COPY OF A WRITTEN COST ESTIMATE FOR MAGNETIC MEDIA FILING FROM A SERVICE AGENCY; FOR 500 OR LESS, SUBMIT AN ESTIMATE AS DESCRIBED ABOVE.

.11 If you request a waiver from filing on magnetic media and it *is* approved, *do not send a copy of the approved waiver to the service centers.* Do *not* staple, paperclip or use rubberbands on any scannable forms. Paper returns are read by an optical scanner (OCR) at the service center.

.12 Waivers are granted on a case-by-case basis and may be approved at the discretion of the service center or National Computer Center Magnetic Media Coordinators. Refer to Part A, Sec. 13 for addresses. Waiver requests should be filed 90 days before the due date of the return, except as stated in

Sec. 5.08 above.

13. If you are required to file on magnetic media but fail to do so, and you do not have an approved waiver on record, you may be subject to a failure to file penalty. Refer to Sec. 6.02 below.

14. *An approved waiver from filing information returns on magnetic media does not provide exemption from ALL filing; you MUST submit your information returns on acceptable paper forms.*

.15 A magnetic tape reporting package, which includes all the necessary transmittals, labels, and instructions, will be mailed to all approved filers between October and December and each year.

SEC. 6. FILING OF MAGNETIC MEDIA REPORTS

.01 Section 6011(e) of the Internal Revenue Code, as amended by the Interest and Dividend Tax Compliance Act of 1983, Pub. L. 98-67, 1983-2 C.B. 352, requires that any person, including individuals, estates and trusts, required to file more than 50 information returns in the aggregate for payments of interest (Forms 1099-INT and 1099-OID), dividends (Form 1099-DIV) or patronage dividends (Form 1099-PATR) for any calendar year, must file such returns on magnetic media. For example, if a payer must file 30 Forms 1099-DIV and 25 Forms 1099-INT, filing on magnetic media is required. This requirement shall not apply if you establish that it will cause you undue hardship. Refer to Sec. 5 above.

.02 The penalty for both the failure to timely file certain information returns and failure to file returns as prescribed by IRS is now $50 per payee up to a maximum of $50,000 a year. However, there is no maximum penalty for returns of 1099-INT, 1099-OID, 1099-DIV, 1099-PATR or 5498. If the failure to file is due to intentional disregard of the filing requirements, the penalty may be greater than $50 per payee and there is no maximum penalty.

.03 Generally, payers are now subject to a $50 penalty for *each* failure to include the payee's correct TIN on an information return.

.04 Rev. Proc. 84-24, 1984-1 C.B. 465, gives detailed information on preparing transmittal documents for information returns and is available at your local IRS office. Specific guidelines are given on how to report the payer's name, address and TIN on transmittal documents and information returns. Instructions for multiple transmittals and the submission of transmittals by service bureaus or agents are also covered.

.05 *THE MAGNETIC TAPE RECORDS ARE TO BE SUBMITTED TO THE NATIONAL COMPUTER CENTER; HOWEVER, PAPER INFORMATION RETURNS ARE TO CONTINUE TO BE FILED WITH THE APPROPRIATE SERVICE CENTERS. See Part A, Sec. 13 for addresses.* Form 4804, Transmittal of Information Returns Reported on Magnetic Media, must accompany magnetic tape submissions. If you file for multiple payers and have the authority to sign the affidavit on Form 4804, you should also submit Form 4802, Multiple Payer Transmittal for Magnetic Media Reporting.

For the IRS to ensure that your actual data records were formatted following THIS revenue procedure, include a hardcopy printout, fast print or tape dump showing a sample of each type of record (A, B, C, K and F) used on the tape. This will be reviewed prior to actual processing to ensure that the data is in the proper format. Be sure to include Form 4804, 4802 or computer generated listing *with* your tape shipment. IRS encourages the use of a computer generated Form 4804 which includes *all* necessary information requested on the actual form. *DO NOT MAIL THE TAPES AND THE TRANSMITTAL DOCUMENTS SEPARATELY.*

Paper information returns must be transmitted to the appropriate service center using Form 1096, Annual Summary and Transmittal of U.S. Information Returns. *Do not send information returns filed on paper forms to the National Computer Center.*

.06 The affidavit which appears on Form 4804 should be signed by the payer; however, the transmitter, service bureau, paying agent, or disbursing agent may sign the affidavit on behalf of the payer if all of the following conditions are met:

(a) It has the authority to sign the affidavit under an agency agreement (either oral, written, or implied) that is valid under the state law.

(b) It has the responsibility (either oral, written, or implied) conferred on it by the payer to request the TINs of borrowers, recipients, or participants reported on magnetic media or paper returns.

(c) It signs the affidavit and adds the caption "For: (name of payer)."

.07 Although a duly authorized agent signs the affidavit, the payer is held responsible for the accuracy of the Form 4804, and the payer will be liable for penalties for failure to comply with filing requirements.

.08 If a portion of the returns is submitted on paper documents with the service center, include a statement on the Form 1096 that the remaining returns are being filed on magnetic media with the National Computer Center. DO NOT REPORT THE SAME INFORMATION ON PAPER FORMS THAT YOU REPORT ON MAGNETIC MEDIA. IF YOU REPORT PART OF YOUR RETURNS ON PAPER AND PART ON MAGNETIC MEDIA, BE SURE THAT DUPLICATE RETURNS, WITH THE SAME INFORMATION, ARE NOT INCLUDED ON BOTH. This does not mean that corrected documents are not to be filed. If a return has been prepared and submitted improperly, you must file a corrected return as soon as possible. Refer to Part A, Sec. 10 for requirements and instructions on filing corrected returns.

.09 Reports from different branches for one payer *MUST* be consolidated under one Payer/Transmitter "A" Record for each type of information return. For example, all Forms 1099-INT must be sorted together under one Payer/Transmitter "A" Record followed by the appropriate "B" Records and one "C" Record.

.10 Health care carriers, or their agents, filing Form 1099-MISC per Part A, Sec. 5.07, may submit part of their returns on paper documents and part on magnetic media if the records of some departments are not maintained on computer files. However, an information return is required if the aggregate amount paid to a health care service provider from all departments equals $600 or more. For example, Department A pays $200, Department B pays $300, and Department C pays

$100 to the same health care service provider. The aggregate amount paid from all departments equals $600. The health care carrier or agent must submit either one information return for the aggregate amount of $600 or three separate returns from the departments, indicating the amount paid by each department.

.11 Before submitting magnetic media files, include the following:

(a) A signed Form 4804 or computer generated substitute. If you send *two* copies of the Form 4804, one will be used as an acknowledgement.

(b) A Form 4802 (if you transmit for multiple payers).

(c) A hard copy printout or listing of the first five and last two blocks of your file. The listing should show a sample of each type of record (A, B, C, K and F) used on the magnetic media being submitted.

(d) The magnetic media with an external identification label as described in Part B, Sec. 1.

(e) On the outside of the shipping container, include a Form 4801 or a substitute for the form which reads "DELIVER UNOPENED TO TAPE LIBRARY—MAGNETIC MEDIA REPORTING—BOX ___ of ___." If there is only one container, mark the outside as Box *1* of *1*. For multiple containers, include the sequence (i.e., Box *1* of *33*, *2* of *33*, etc.).

(f) If you were granted an extension and are filing late, include a copy of the approved extension letter with the magnetic media.

.12 IRS will not pay or accept "Collect on Delivery" or "Charged to IRS" shipments of reportable tax information that an individual or organization is legally required to submit. The current policy is to return magnetic materials or requested information at U.S. Government expense.

.13 Files returned to you due to coding or format errors are to be corrected and returned to IRS within 30 days of receipt by the filer.

SEC. 7. FILING DATES

.01 The dates prescribed for filing paper returns with IRS also apply to magnetic media filing. Magnetic media reporting to the IRS for all types of Form 1098, 1099 Series, 5498, and W-2G must be on a calendar year basis.

.02 Information returns filed on magnetic media for Forms 1098, all types of Forms 1099, and W-2G must be submitted to IRS by February 28. The due date for furnishing the required copy or statement to the recipient is January 31.

.03 Information returns filed on magnetic media for Forms 5498 must be submitted to IRS by May 31. Copies of this form or statements are due to the participant by May 31 for contributions made to IRAs and SEPs; however, participant copies or statements for DECs are due the time the contribution is made or January 31, whichever is the later. Form 5498 is filed for contributions to be applied to 1985 that are made between January 1, 1985, and April 15, 1986.

SEC. 8. EXTENSIONS OF TIME TO FILE

.01 If a payer or transmitter of returns on magnetic media is unable to submit their magnetic media file by the dates prescribed in Sec. 7.02 and 7.03 above, submit a letter requesting an extension of up to 30 days to file, as soon as you are aware that an extension will be necessary. The request *MUST* be filed *before* the due date of the return. The letter should be sent to the attention of the Magnetic Media Reporting Program at the National Computer Center where the tape file is to be submitted. See Part A, Sec. 13 for the address. The request should include:

(a) The filer's name and address.

(b) The filer's Taxpayer Identification Number (SSN or EIN).

(c) The tax year for which the extension of time is requested: Tax Year 1985.

(d) The name and telephone number of a person to contact who is familiar with the request.

(e) The type of returns and expected volume.

(f) The Transmitter Control Code assigned to the organization or individual requesting the extension (if a number has been assigned).

(g) The reason for the delay and date that you *will* be able to file.

.02 If an extension of time to file on magnetic media is granted by the National Computer Center, a *copy* of the letter *granting the extension MUST* be attached to the transmittal Form 4804 or computer generated substitute when the file is submitted.

SEC. 9. PROCESSING OF MAGNETIC MEDIAL RETURNS

.01 The National Computer Center will process tax information from magnetic media files. All magnetic media files that are received timely by the National Computer Center will be returned to the filers by August 15 of the year in which submitted.

.02 After January 1, 1986, all magnetic media processing will be centralized at the National Computer Center. Due to the volume of input received and the cost to return special containers, special shipping containers should not be used for transmitting data to the National Computer Center since IRS cannot guarantee return of such containers.

.03 Files will be returned to you for correction if they are unprocessable due to format or coding errors, or by the request of the filer. Files must be corrected and returned to the National Computer Center within 30 days of receipt by the filer. The corrected files will be returned to the filer by the National Computer Center within 6 months of receipt. PLEASE BE SURE THAT YOUR FORMAT AND CODING COMPLY WITH THIS REVENUE PROCEDURE. *THIS REVENUE PROCEDURE IS TO BE USED FOR THE PREPARATION OF TAX YEAR 1985 INFORMATION RETURNS ONLY*. AS SOME LEGISLATIVE AND FORMS CHANGES AFFECTING INFORMATION RETURNS OCCUR EACH YEAR, THIS PROCEDURE IS UPDATED TO REFLECT NECESSARY CHANGES. PLEASE READ THIS PUBLICATION CAREFULLY.

SEC. 10. HOW TO FILE CORRECTED RETURNS

.01 If a return has been prepared and submitted improperly, you must file a complete corrected return as soon as possible. *ALL FIELDS OR BOXES MUST BE COMPLETED WITH THE CORRECT INFORMATION, NOT JUST THE DATA FIELDS NEEDING CORRECTION*. If you file corrected returns on paper forms, submit Copy A to the appropriate service center. There are numerous types of errors. It may

require more than one transaction to properly correct the initial error. You are strongly encouraged to read this *ENTIRE* section before attempting to make *ANY* correction. If the initial return was filed as an aggregate, you must consider this in filing the corrected returns.

.02 Corrected returns submitted to IRS on magnetic media, using a "G" coded Payee "B" Record, may be submitted on the same tape as those corrections submitted without the "G" code; however, they must be submitted using a separate "A" Record. Corrected returns for different tax years may not be submitted on the same file. Corrected returns are to be identified as corrections on the transmittal document and on the *EXTERNAL* label of the file.

.03 The instructions that follow will provide information on how to file corrected returns on magnetic media *and* on paper forms. Please refer to the appropriate chart *and* type of error for instructions on how to *properly* file the corrected return(s).

.04 You may file corrected returns on paper forms; however, you are encouraged to file on magnetic media if you file *more* than 50 corrected returns.

.05 If you file your corrected returns on paper forms, do not submit the paper returns to the National Computer Center. *All paper returns, whether original or corrected, must be filed with the appropriate service center. Corrected returns filed on magnetic media must be filed with the National Computer Center.* Refer to Part A, Sec. 13 for address information.

.06 Statements to the recipient or participant should be identified as "CORRECTED" and should be provided to them as soon as possible.

.07 If you file corrected returns on paper forms, use IRS forms or acceptable OCR scannable paper substitutes. Always submit Copy A to the appropriate service center. *NOTE:* Form W-2G is not required to be in OCR scannable format. Publication 1179, "Requirements for Reproducing Paper Substitutes of Forms 1096, 1099 Series, 5498, W-2G and W-3G" provides requirements and instructions. A supplement will be issued to include instructions for paper substitutes of Form 1098, Mortgage Interest Statement.

.08 For further instructions on filing information returns with IRS, refer to the 1985 "Instructions for Form 1099 Series, 1098, 5498 and 1096." If these instructions are not included in your magnetic media reporting packages, request a copy from your local IRS office.

.09 Type or machine print all information on returns filed on paper.

.10 Use the proper form. If you are in doubt, review the instructions noted in .08 above or contact your local IRS office.

.11 Use only the boxes provided on the paper forms. Do not add additional boxes.

.12 Do not change the title of any box on the paper forms.

.13 Use the same name and TIN (SSN or EIN) for the filer on the Form 1096 transmittal form and all related forms that follow.

.14 A separate transmittal Form 1096 is required for each *type* of paper information return filed in the 1098, 5498 and 1099 Series. A transmittal Form W-3G is required to transmit paper Forms 1099-R and W-2G. DO NOT USE THE SAME TRANSMITTAL DOCUMENT TO FILE ORIGINAL AND CORRECTED RETURNS WHETHER ON PAPER FORMS *OR* MAGNETIC MEDIA. A transmittal Form 4804 or computer generated substitute is used to transmit magnetic media. A Form 4802 is a *continuation* form for a Form 4804. Please utilize a Form 4802 if you file on magnetic media for multiple payers and are an authorized agent for the payer.

.15 Do not staple, fold, paperclip or use rubberbands on any paper information returns filed with IRS. This could impair the OCR scanning process.

.16 Use the correct tax year's forms to file information returns with IRS (i.e., do not submit tax year 1985 returns using 1984 forms). The same is true for magnetic media filing. You must submit your returns filed on magnetic media using the revenue procedure for the tax year of the returns. Forms and revenue procedures are normally updated each year to include necessary changes.

.17 Most information returns contain a "VOID" box and a "CORRECTED" box. The "VOID" box is used only if you make an error while typing or printing the paper forms. Mark this box ONLY when you wish the return to be disregarded or passed over. The OCR scanner at the service centers *will not read* a "VOID" return; it will pass over it and go to the next form if the "VOID" box is marked. Do not confuse the "VOID" box and the "CORRECTED" box.

.18 On magnetic media files, the Payee "B" Record provides space to enter a Payer's Account Number for the Payee. This same account number may be provided on paper forms. In order to properly file corrected returns, this number will help identify the appropriate incorrect return. DO NOT ENTER A TIN (SSN OR EIN). *A PAYER'S ACCOUNT NUMBER FOR THE PAYEE MAY BE A CHECKING ACCOUNT NUMBER, SAVINGS ACCOUNT NUMBER, SERIAL NUMBER OR ANY OTHER NUMBER ASSIGNED TO THE PAYEE BY THE PAYER, WHICH WILL DISTINGUISH THE SPECIFIC ACCOUNT. THIS NUMBER MUST APPEAR ON THE INITIAL RETURN AND ON THE CORRECTED RETURN IN ORDER TO IDENTIFY AND PROCESS THE CORRECTION PROPERLY.*

.19 REVIEW BOTH CHARTS 1 AND 2 THAT FOLLOW. The types of errors made will *normally* fall under one of the four categories listed. Next to each *type* of error made, you will find a list of instructions to tell you how to *properly* file the corrected return for *that* type of error. READ ALL OF THE INSTRUCTIONS LISTED AND FOLLOW THEM FOR THE TYPE OF ERROR MADE ON THE INITIAL RETURN. *IN SOME CASES TWO TRANSACTIONS ARE REQUIRED TO PROPERLY FILE CORRECTIONS. IF THE ORIGINAL RETURN WAS FILED AS AN AGGREGATE, YOU MUST CONSIDER THIS IN FILING THE CORRECTED RETURNS.*

CHART 1. *Guidelines for Filing Corrected Returns On Magnetic Media*

(PLEASE READ SEC. 10.01 THROUGH 10.19 OF THIS PUBLICATION BEFORE MAKING *ANY* CORRECTIONS)

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On Magnetic Media
1. Original return was filed with *NO* Payee TIN (SSN or EIN), *OR* the return was filed with an *INCORRECT* Payee TIN (SSN or EIN). THIS WILL REQUIRE TWO SEPARATE TRANSACTIONS TO MAKE THE CORRECTION PROPERLY. READ AND FOLLOW ALL INSTRUCTIONS FOR BOTH TRANSACTIONS 1 AND 2.	*TRANSACTION 1:* Identifying return submitted with *NO* TIN or an *INCORRECT* TIN A. *Form 4804 and/or 4802 (or computer generated substitute)* 1. Prepare a *new* transmittal Form 4804 (and 4802 if you file for multiple payers), or a computer generated substitute, that includes information related to this new file. (A Form 4802 is a continuation form for multiple payers and may be used if you have the authority to sign the affidavit on the Form 4804.) 2. Write, type or machine print in uppercase letters "MAGNETIC MEDIA CORRECTION" at the top of the transmittal form or computer generated substitute. 3. Provide *ALL* requested information correctly. 4. Include a hardcopy print, listing or tape dump exhibiting a small sample of each type of *record* (A, B, C and F), which can be reviewed for accuracy and acceptability of record) *format*. 5. If you are a Combined Federal/State filer, IRS will not transmit corrected returns to the state. This will be the responsibility of the filer. B. *1098, 1099 Series, 5498 and W–2G Returns* 1. Prepare a new file. 2. Use a separate Payer/Transmitter "A" Record for each *type* of return being reported. The information in the "A" Record will be the same as it was in the original submission. 3. The Payee "B" Record must contain exactly the same information as submitted previously *EXCEPT:* insert a "G" code in tape position 5 of the "B" Record *AND* for ALL payment amounts *used*, enter "0" (zero). 4. Corrected returns submitted to IRS using a "G" coded "B" Record may be submitted on the same tape as those corrections submitted *without* the "G" code; however, a separate "A" Record is required. 5. Mark the *EXTERNAL* label of the tape "MAGNETIC MEDIA CORRECTION." 6. Submit the tape(s), a tape dump showing sample records coded for this type of filing, and the transmittal document to the National Computer Center. (Refer to Part A, Sec. 13 for address information.) *TRANSACTION 2:* Reporting the correct information A. *Form 4804 and/or 4802 (or computer generated substitute)* 1. If you submit records with the corrected information on a separate tape from those that are "G" coded, prepare a *new* Transmittal Form 4804 (and 4802 if you file for multiple payers), or a computer generated substitute, that includes information related to this new file. (A Form 4802 is a continuation form for multiple payers and may be used if you have the authority to sign the affidavit on the Form 4804.) 2. Write, type or machine print in uppercase letters "MAGNETIC MEDIA CORRECTION" at the top of the transmittal form or computer generated substitute.

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On Magnetic Media
	3. Provide *ALL* requested information correctly. 4. Include a hardcopy print, listing or tape dump exhibiting a small sample of each type of *record* (A, B, C and F), which can be reviewed for accuracy and acceptability of record *format*. 5. If you are a Combined Federal/State filer, IRS will not transmit corrected returns to the state. This will be the responsibility of the filer. B. *1098, 1099 Series, 5498 and W-2G Returns* 1. Prepare a *new* file with the correct information in *ALL* records. 2. Use a separate Payer/Transmitter "A" Record for each *type* of return being reported. 3. *Do not code the payee "B" Record as a corrected return for this type of correction.* (Remove the "G" Code.) 4. Provide all of the correct information supplying the correct TIN (SSN or EIN). 5. Mark the *EXTERNAL* label of the tape "MAGNETIC MEDIA CORRECTION". 6. Submit the tape(s), a tape dump showing sample records coded for this type of filing, and the transmittal document to the National Computer Center. (Refer to Part A, Sec. 13 for address information.)
2. Original return was filed with an incorrect payment amount(s) in the Payee "B" Record, *OR* a money amount was reported using an incorrect Payment Amount Indicator Code in the original Payer/Transmitter "A" Record. Correct *Type Of Return* indicator was used in the "A" Record. THIS WILL REQUIRE ONLY ONE TRANSACTION TO MAKE THE CORRECTION. (NOTE: If the wrong *Type Of Return* indicator was used, see number 3 of this chart.)	A. *Form 4804 and/or 4802 (or computer generated substitute)* 1. Prepare a *new* transmittal Form 4804 (and 4802 if you file for multiple payers), or a computer generated substitute, that includes information related to this new file. (A Form 4802 is a continuation form for multiple payers and may be used if you have the authority to sign the affidavit on the Form 4804.) 2. Write, type or machine print in uppercase letters "MAGNETIC MEDIA CORRECTION" at the top of the transmittal form or computer generated substitute. 3. Provide *ALL* requested information correctly. 4. Include a hardcopy print, listing or tape dump exhibiting a small sample of each type of *record* (A, B, C and F), which can be reviewed for accuracy and acceptability of record *format*. 5. If you are a Combined Federal/State filer, IRS will not transmit corrected returns to the state. This will be the responsibility of the filer. B. *1098, 1099 Series, 5498 and W-2G Returns* 1. Prepare a *new* file. 2. Use a separate Payer/Transmitter "A" Record for each *type* of return being reported. The information in the "A" Record will be the same as it was in the original submission EXCEPT, the *correct* Amount Indicators will be used. 3. The Payee "B" Record must contain exactly the same information as submitted previously *EXCEPT:* insert a "G" code in tape position 5 of the "B" Record *AND* report the correct payment amounts as they should have been reported on the initial return. 4. Corrected returns submitted to IRS using a "G" coded

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On Magnetic Media
	"B" Record may be submitted on the same tape as those corrections submitted *without* the "G" code; however, a separate "A" Record is required. 5. Mark the *EXTERNAL* label of the tape "MAGNETIC MEDIA CORRECTION". 6. Submit the tape(s), a tape dump showing sample records coded for this type of filing, and the transmittal document to the National Computer Center. (Refer to Part A, Sec. 13 for address information.)
3. Original return was filed using the WRONG *Type of Return* indicator in the Payer/Transmitter "A" Record. (For example, a return was coded using the *Type of Return* indicator for 1099-DIV and it should have been coded 1099-INT.) THIS WILL REQUIRE TWO SEPARATE TRANSACTIONS TO MAKE THE CORRECTION PROPERLY. READ AND FOLLOW *ALL* INSTRUCTIONS FOR *BOTH* TRANSACTIONS 1 AND 2.	*TRANSACTION 1:* Identifying return submitted with an incorrect Type Of Return indicator A. *Form 4804 and/or 4802 (or computer generated substitute)* 1. Prepare a *new* transmittal Form 4804 (and 4802 if you file for multiple payers), or a computer generated substitute, that includes information related to this new file. (A Form 4802 is a continuation form for multiple payers and may be used if you have the authority to sign the affidavit on the Form 4804.) 2. Write, type or machine print in uppercase letters "MAGNETIC MEDIA CORRECTION" at the top of the transmittal form or computer generated substitute. 3. Provide *ALL* requested information correctly. 4. Include a hardcopy print, listing or tape dump exhibiting a small sample of each type of *record* (A, B, C and F), which can be reviewed for accuracy and acceptability of record *format*. 5. If you are a Combined Federal/State filer, IRS will not transmit corrected returns to the state. This will be the responsibility of the filer. B. *1098, 1099 Series, 5498 and W-2G Returns* 1. Use a separate Payer/Transmitter "A" Record for each *type* of return being reported. The information in the "A" Record will be exactly the same as it was in the original submission using the same incorrect type of return indicator. 2. The corrected Payee "B" Record must contain the same information as submitted previously *EXCEPT:* insert a "G" code in tape position 5 of the "B" Record and for *ALL* payment amounts *used*, enter "0" (zero). 3. Corrected returns submitted to IRS using a "G" coded "B" Record may be submitted on the same tape as those corrections submitted *without* the "G" code; however, a separate "A" Record is required. 4. Mark the *EXTERNAL label of the tape "MAGNETIC MEDIA CORRECTION."* 5. Submit the tape(s), a tape dump showing sample records coded for this type of filing, and the transmittal document to the National Computer Center. (Refer to Part A, Sec. 13 for address information.) *TRANSACTION 2:* Reporting the correct information A. *Form 4804 and/or 4802 (or computer generated substitute)* 1. If you submit records with the corrected information on a separate tape from those that are "G" coded, prepare a *new* transmittal Form 4804 (and 4802 if you file for

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On Magnetic Media
	multiple payers), or a computer generated substitute, that includes information related to this new file. (A Form 4802 is a continuation form for multiple payers and may be used if you have the authority to sign the affidavit on the Form 4804.) 2. Write, type or machine print in uppercase letters "MAGNETIC MEDIA CORRECTION" at the top of the transmittal form or computer generated substitute. 3. Provide *ALL* requested information correctly. 4. Include a hardcopy print, listing or tape dump exhibiting a small sample of each type of *record* (A, B, C and F), which can be reviewed for accuracy and acceptability of record *format*. 5. If you are a Combined Federal/State filer, IRS will not transmit corrected returns to the state. This will be the responsibility of the filer B. *1098, 1099 Series, 5498 and W-2G Returns* 1. Prepare a *new* file with the correct information in *ALL* records. 2. Use a separate Payer/Transmitter "A" Record for each *type* of return being reported and use the correct Type of Return indicator. 3. *Do not code the Payee "B" Record as a corrected return for this type of correction.* (Remove the "G" Code.) 4. Provide all of the correct information. 5. Mark the *EXTERNAL* label of the tape "MAGNETIC MEDIA CORRECTION". 6. Submit the tape(s), a tape dump showing sample records coded for this type of filing, and the transmittal document to the National Computer Center. (Refer to Part A, Sec. 13 for address information.)

CHART 2. *Guidelines for Filing Corrected Returns On Paper Forms*

(PLEASE READ SEC. 10.01 THROUGH 10.19 OF THIS PUBLICATION BEFORE MAKING *ANY* CORRECTIONS.)

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On PAPER forms
1. Original return was filed with *NO* Payee TIN (SSN or EIN) *OR* the return was filed with an *INCORRECT* Payee TIN. THIS WILL REQUIRE TWO SEPARATE TRANSACTIONS TO MAKE THE CORRECTION PROPERLY. READ AND FOLLOW *ALL* INSTRUCTIONS FOR BOTH TRANSACTIONS 1 *AND* 2.	*TRANSACTION 1:* Identifying return submitted with *NO* TIN or an *INCORRECT* TIN A. *Form 1096 or W-3G* 1. Prepare a *new* transmittal Form 1096 or W-3G depending on the *type* of return being filed. 2. *Mark over the "X" in the "CORRECTED" box at the top of the form.* 3. Provide *all* requested information correctly. 4. Type or machine print in upper case letters "MAGNETIC MEDIA CORRECTION" in the blank space below the instructions. 5. Do *NOT* staple this transmittal form to the related returns. 6. Use a separate transmittal form for each *type* of return. 7. A transmittal Form 1096 or W-3G *MUST* be present. (Refer to .14 of this section for clarification.)

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On PAPER forms

B. *Form 1098, 1099 Series, 5498 or W-2G*
1. Prepare a *new* information return on the proper *type* of form.
2. *Mark over the "X" in the "CORRECTED" box at the top of the form(s).*
3. Enter the Payer, Recipient and Account Number information (if any) *exactly* as it appeared on the original incorrect return filed with *NO* TIN or *INCORRECT* TIN; HOWEVER, enter "0" (zero) for *all* money amounts.
4. File the transmittal document and Copy A of the returns with the appropriate service center.
5. Do *NOT* cut the forms that are three to a page.
6. Do *NOT* staple, paperclip or use rubberbands on the forms.
7. Use a separate transmittal Form 1096 or Form W-3G (depending on the *type* of return) to transmit the "CORRECTED" return(s).
8. *Do NOT include copies of the original return that was filed incorrectly.*

TRANSACTION 2: Reporting correct information

A. *Form 1096 or W-3G:*
1. Prepare a *new* transmittal Form 1096 or W-3G depending on the *type* of return being filed.
2. *Do NOT mark over the "X" in the "CORRECTED" box at the top of the form for THIS type of correction.*
3. Provide *all* requested information correctly.
4. Type or machine print in upper case letters "MAGNETIC MEDIA CORRECTION" in the blank space below the instructions.
5. Do *NOT* staple this transmittal form to the related returns.
6. Use a separate transmittal form for each *type* of return.
7. A transmittal Form 1096 or W-3G *MUST* be present. (Refer to .14 of this section for clarification.)

B. *Form 1098, 1099 Series, 5498 or W-2G:*
1. Prepare a *new* information return on the proper *type* of form.
2. *Do NOT mark over the "X" in the "CORRECTED" box at the top of the form(s) for this type of correction.* Submit the *new* returns as though they were originals.
3. Include *all* of the correct information supplying the TIN (SSN or EIN).
4. File the transmittal document and Copy A of the returns with the appropriate service center.
5. Do *NOT* cut the forms that are three to a page.
6. Do *NOT* staple, paperclip or use rubberbands on the forms.
7. Use a separate transmittal Form 1096 or W-3G (depending on the *type* of return) to transmit the corrected returns. *You MUST NOT use the same transmittal used in Transaction 1.*
8. *Do NOT include copies of the original return that was filed incorrectly.*

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On PAPER forms
2. Original return was filed with incorrect payment amount(s) in the Payee "B" Record, OR a money amount was reported using an incorrect Payment Amount Indicator Code in the original Payer/Transmitter "A" Record. Correct *Type* of *Return* indicator was used in the "A" Record. THIS WILL REQUIRE ONLY ONE TRANSACTION TO MAKE THE CORRECTION. (If the WRONG *Type* of *Return* indicator was used, see number 3 of this chart.)	A. *Form 1096 or W-3G* 1. Prepare a *new* transmittal Form 1096 or W-3G depending on the *type* of return being filed. 2. *Mark over the "X" in the "CORRECTED" box at the top of the form.* 3. Provide *all* requested information correctly. 4. Type or machine print in upper case letters "MAGNETIC MEDIA CORRECTION" in the blank space below the instructions. 5. Do *NOT* staple this transmittal form to the related returns. 6. Use a separate transmittal form for each *type* of return. 7. A transmittal Form 1096 or W-3G *MUST* be present. (Refer to .14 of this section for clarification.) B. *Form 1098, 1099 Series, 5498 or W-2G* 1. Prepare a *new* information return on the proper *type* of form. 2. *Mark over the "X" in the "CORRECTED" box at the top of the form*(s). 3. Enter the Payer, Recipient and Account Number information *exactly* as it appeared on the original incorrect return; HOWEVER, *enter all correct money amounts in the correct boxes as they should have appeared on the original return.* 4. File the transmittal document and Copy A of the returns with the appropriate service center. 5. Do *NOT* cut the forms that are three to a page. 6. Do *NOT* staple, paperclip or use rubberbands on the forms. 7. Use a separate transmittal Form 1096 or W-3G (depending on the *type* of return) to transmit the corrected returns. 8. *Do NOT include copies of the original return that was filed incorrectly.*
3. Original return was filed using the WRONG *Type of Return* indicator in the Payer/Transmitter "A" Record. (For example, a return was coded using the *Type of Return* indicator for 1099-DIV and it should have been coded as 1099-INT.) THIS WILL REQUIRE TWO SEPARATE TRANSACTIONS TO MAKE THE CORRECTION PROPERLY. READ AND FOLLOW *ALL* INSTRUCTIONS FOR BOTH TRANSACTIONS 1 AND 2.	*Transaction 1:* Identifying return submitted with an incorrect Type of Return indicator A. *Form 1096 or W-3G* 1. Prepare a *new* transmittal Form 1096 or W-3G depending on the *type* of return being filed. 2. *Mark over the "X" in the "CORRECTED" box at the top of the form.* 3. Provide *all* requested information correctly. 4. Type or machine print in upper case letters "MAGNETIC MEDIA CORRECTION" in the blank space below the instructions. 5. Do *NOT* staple this transmittal form to the related returns. 6. Use a separate transmittal form for each *type* of return. 7. A transmittal Form 1096 or W-3G *MUST* be present. (Refer to .14 of the section for clarification.) B. *Form 1098, 1099 Series, 5498 or W-2G* 1. *Prepare a new information return utilizing the same type of form that was used initially.* 2. *Mark over the "X" in the "CORRECTED" box at the top of the form(s).*

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On PAPER forms

3. Enter the Payer, Recipient and Account Number information *exactly* as it appeared on the original incorrect return; HOWEVER, enter "0" (zero) for *all* money amounts.
4. File the transmittal document and Copy A of the returns with the appropriate service center.
5. Do *NOT* cut the forms that are three to a page.
6. Do *NOT* staple, paperclip or use rubberbands on the forms.
7. Use a separate transmittal Form 1096 or W-3G (depending on the *type* of return) to transmit the "Corrected" return(s).
8. *Do NOT include copies of the original return that was filed incorrectly.*

TRANSACTION 2: Reporting correct information on the correct *type* of return

A. *Form 1096 or W-3G*
1. Prepare a *new* transmittal Form 1096 or W-3G depending on the *type* of return being filed.
2. *Do NOT mark over the "X" in the "CORRECTED" box at the top of the form for THIS type of correction.*
3. Provide *all* requested information correctly.
4. Type or machine print in upper case letters "MAGNETIC MEDIA CORRECTION" in the blank space below the instructions.
5. Do *NOT* staple this transmittal form to the related returns.
6. Use a separate transmittal form for each *type* of return.
7. A transmittal Form 1096 or W-3G *MUST* be present. (Refer to .14 of this section for clarification.)

B. *Form 1098, 1099 Series, 5498 or W-2G*
1. Prepare a *new* information return utilizing the proper *type* of form.
2. *Do NOT mark over the "X" in the "CORRECTED" box at the top of the form(s) for this type of correction.* Submit the new return(s) as though they were originals.
3. Include *all* of the correct information.
4. File the transmittal document and Copy A of the returns with the appropriate service center.
5. Do *NOT* cut the forms that are three to a page.
6. Do *NOT* staple, paperclip or use rubberbands on the forms.
7. Use a separate transmittal form 1096 or W-3G (depending on the *type* of return) to transmit the corrected returns. You *MUST NOT* use the same transmittal used in Transaction 1.
8. *Do NOT include copies of the original return that was filed incorrectly.*

SEC. 11. TAXPAYER IDENTIFICATION NUMBERS

.01 Under section 6109 of the Internal Revenue Code, recipients of all reportable payments on information returns are required to furnish Taxpayer Identification Numbers (TINs) to the payer. The number must be furnished to the payer whether or not the payee is required to file a tax return or is covered by social security. Refer to Sec. 15 for a definition of Taxpayer Identification Number (TIN).

.02 The recipient's TIN is used to associate and verify amounts reported

to IRS with corresponding amounts on tax returns. Therefore, it is particularly important that correct social security and employer identification numbers for payees be provided on magnetic media or paper forms submitted to IRS. *DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROES.*

.03 Under section 6676 of the Internal Revenue Code, a $50 penalty applies for each failure to furnish a TIN to another person who is required to file an information return, and for each failure to include a TIN on an information return. The penalty for payments other than interest or dividends applies unless the failures were due to reasonable cause and not willful neglect.

.04 With respect to all payers of interest and dividends, section 6676 of the Internal Revenue Code provides that the payer must self-assess a *$50 penalty* for each failure to include a payee's TIN or each inclusion of an incorrect TIN on an information return, unless the payer can demonstrate that the payer met the due diligence requirements in attempting to acquire correct TINs for payees. Use Form 8210, Self-Assessed Penalties Return.

.05 For any reportable payment, if the payee fails to provide a TIN to the payer or if IRS notifies you that the TIN provided is incorrect, then backup withholding must be instituted for that payee. In the case of notice of an incorrect TIN from IRS, the payer must begin withholding on the 31st day after the notice is received. If the payer receives another TIN in the manner required from the payee within 30 days of notice from IRS, no withholding is required.

.06 The TIN to be furnished to IRS depends primarily upon the manner in which the account is maintained or set up on the payer's record. The TIN to be provided must be that of the owner of the account. If the account is recorded in more than one name, furnish the TIN and name of one of the owners of the account. The TIN provided must be associated with the name of the payee provided in the first name line of the Payee "B" Record. For individuals, including sole proprietors, the payee TIN is the payee's social security number. For other entities, the payee TIN is the payee's employer identification number.

.07 Sole proprietors who are payers should show their employer identification number in the Payer/Transmitter "A" Record. However, sole proprietors who are not otherwise required to have an employer identification number should use their social security number.

.08 Sole proprietors' social security numbers must be used in the Payee "B" Record.

.09 The charts below will help you determine the number to be furnished to IRS for recipients of reportable payments (payees).

CHART 1. Guidelines for Social Security Numbers

For this type of account:	In the Taxpayer Identification Number field of the Payee "B" Record, enter the SSN of—	In the First Payee Name Line of the Payee "B" Record, enter the name of—
1. An individual's account.	The individual.	The individual.
2. A joint account (Two or more individuals, husband and wife).	The actual owner of the account. (If more than one owner, the first individual on the account.)	The individual whose SSN is entered.
3. Account in the name of a guardian or committee for a designated ward, minor, or incompetent person.	The ward, minor, or incompetent person.	The individual whose SSN is entered.
4. Custodian account of a minor (Uniform Gift to Minors Act).	The minor.	The minor.
5. The usual revocable savings trust account (grantor is also trustee).	The grantor-trustee.	The grantor-trustee.
6. A so-called trust account that is not a legal or valid trust under state law.	The actual owner.	The actual owner.
7. A sole proprietorship.	The owner.	The owner.

CHART 2. Guidelines for Employer Identification Numbers

For this account type—	In the Taxpayer Identification Number field of the Payee "B" Record, enter the EIN of—	In the First Payee Name Line of the Payee "B" Record, enter the name of—
1. A valid trust, estate, or pension trust.	Legal entity.[1]	The legal trust, estate, or pension trust.
2. A corporate account.	The corporation.	The corporation.
3. An association, club, religious, charitable, educational or other tax-exempt organization.	The organization.	The organization.
4. A partnership account held in the name of the business.	The partnership.	The partnership.
5. A broker or registered nominee/ middleman.	The broker or nominee/ middleman.	The broker or nominee/middleman.
6. Account with the Department of Agriculture in the name of a public entity, such as state or local government, school district or prison, that receives agriculture program payments.	The public entity.	The public entity.

[1]Do not furnish the identification number of the personal representative or trustee unless the name of the representative or trustee is used in the accou title.

SEC. 12. EFFECT ON PAPER RETURNS

.01 Magnetic tape reporting of the information returns listed in Part A, Sec. 1 applies only to the original (Copy A).

.02 For payments of dividends or interest (reported on Forms 1099-DIV, 1099-PATR, 1099-INT or 1099-OID), a payer is required to furnish an official Form 1099 to a payee either in a separate mailing by First-Class mail or in person. These forms may not be combined or mailed with other information furnished to the recipient except Forms W-8, W-9, or other Form 1099 statements. The payer may use substitute Forms 1099 if they are substantially similar to the official forms and if the payer complies with all revenue procedures relating to substitute Forms 1099 in effect at the time (see Publication 1179, Requirements for Reproducing Paper Substitutes of Forms 1096, 1099 Series, 5498, W-2G and W-3G). A supplement will be issued to include instructions for substitutes of Form 1098, Mortgage Interest Statement. Copy B (For Recipient) of the substitute forms must contain the statement "This is important tax information and is being furnished to IRS. If you are required to file a return, a negligence penalty will be imposed on you if this income is taxable and IRS determines that it has not been reported."

.03 Statements to recipients for Forms 1098, 1099-A, 1099-B, 1099-G, 1099-MISC (except for substitute payments in lieu of dividends and tax-exempt interest), 1099-R, 5498 or W-2G need not be a copy of the paper form filed with IRS. It is important that income items be properly classified for Federal tax purposes on the statement the payer gives to recipients. The message "This information is being furnished to IRS" must appear on the statements. The payer may combine the statements with other reports or financial or commercial notices, or expand them to include other information of interest to the recipient. Also, be sure that all copies of the forms are legible and provide the recipient with applicable instructions that appear on the back of the recipient's copy of the official IRS form so that the information may properly be used by the recipient in meeting his or her tax obligations.

.04 If a portion of the returns is reported on magnetic tape and the remainder is reported on paper forms, those returns not submitted on magnetic tape must be filed on official forms or on acceptable paper substitutes meeting specifications in Publication 1179, Requirements for Reproducing Paper Substitutes of Forms 1096, 1099 Series, 5498, W-2G and W-3G. A supplement will be issued to include instructions for substitutes of Form 1098, Mortgage Interest Statement.

SEC. 13. MAGNETIC MEDIA COORDINATOR CONTACTS

.01 On January 1, 1985, the National Computer Center assumed responsibility for the *magnetic media* processing previously handled by the Philadelphia, Kansas City, and Austin Service Centers. Beginning January 1, 1986, magnetic media processing for *all* service centers will be centralized at the National Computer Center. *On or after January 1, 1986, please direct all requests for magnetic media related publications, information, undue hardship waivers, or forms to the following address:*

Magnetic Media Reporting
Internal Revenue Service
National Computer Center
Post Office Box 1359
Martinsburg, WV 25401-1359

Hours of operation at this address will be 8:30 A.M. until 8:00 P.M. Eastern Time Zone.

Prior to January 1, 1986, requests for *magnetic media* related publications, forms, undue hardship waivers, or information will still be handled by the following service centers only:

(a) Internal Revenue Service
Andover Service Center
Post Office Box 311
Stop 481
Andover, MA 01810

(b) Internal Revenue Service
Brookhaven Service Center
Post Office Box 486
Holtsville, NY 11742

(c) Internal Revenue Service
Atlanta Service Center
Post Office Box 47-421
Doraville, GA 30362

(d) Internal Revenue Service
Memphis Service Center
Post Office Box 1900
Memphis, TN 38101

(e) Internal Revenue Service
Cincinnati Service Center
Post Office Box 267
201 West Second Street
Covington, KY 41019

(f) Internal Revenue Service
Ogden Service Center
Post Office Box 9941
1160 West 12th Street
Ogden, UT 84409

(g) Internal Revenue Service
Fresno Service Center
Post Office Box 12866
Fresno, CA 93779

.02 The National Computer Center will process returns filed on magnetic media only. *All* information returns filed on paper forms should be submitted to the appropriate service center, not the National Computer Center. Organizations who file their information returns on magnetic media but who submit their corrected returns on paper forms with the Philadelphia, Kansas City and Austin Service Centers, please use the following addresses for returns filed on paper:

(a) Internal Revenue Service
Philadelphia Service Center
Post Office Box 245
Bensalem, PA 19020

(b) Internal Revenue Service
Kansas City Service Center
2306 East Bannister Road
Stop 36
Kansas City, MO 64131

(c) Internal Revenue Service
Austin Service Center
Post Office Box 934
Austin, TX 78767

SEC. 14. COMBINED FEDERAL/STATE FILING

.01 The Combined Federal/State Program was established to simplify information returns filing for the taxpayer. IRS will accept, upon prior approval, magnetic tape files containing state reporting information only for those states listed in Table 1 in this section. *FORMS 1098, 1099-A, 1099-B and W-2G CANNOT BE FILED UNDER THE COMBINED FEDERAL/STATE FILING PROGRAM.*

.02 To request approval to participate in the Combined Federal/State Program, a "test" file, *coded for this program*, must be submitted between September and December using the revenue procedure that will be used for the actual data files. Refer to Part A, Sec. 13 for address information. See Part A, Sec. 5.04 for general guidelines on submission of "test" files. Each record, both in the "test" file and actual data file, must be 360 positions in length, and the file must conform *exactly* to the revenue procedure for the tax year of the *actual* data. Combined Federal/State records must be coded using each state's dollar criteria from Table 2 of this Section for each *type* of return. If the "test" tape is determined to be acceptable, IRS will return it to the filer with a letter of approval to participate in the Combined Federal/State Program. Form 6847, Consent For Internal Revenue Service to Release Tax Information, will be included with the letter of approval. You *must* complete Form 6847, include your 5 character Transmitter Control Code on the form, and return it to IRS before IRS will release tax information to any of the participating states. Do not submit *actual* data records coded for the Combined Federal/State Program without prior approval from IRS. The first time you submit actual data files coded for this program, include the signed Form 6847.

.03 States that participate in this program and the valid state code assigned to each are listed in Table 1 of this Section. If the state that you wish information released to does *not* participate in the program, do *not* code your records for that state. If the state participates, if you have received prior approval, and if all other conditions are met, IRS will forward the tax information to the participating state at no charge to the filer.

.04 *IF CORRECTIONS MUST BE MADE, IRS WILL NOT TRANSMIT CORRECTED RETURNS TO THE STATES. THIS WILL BE THE RESPONSIBILITY OF THE FILER.*

.05 IRS will make no attempt to process files with any deviations. Approval to participate in the Combined Federal/State Program will be revoked if any files are submitted that do not *totally* conform.

.06 IRS is acting as a forwarding agent *ONLY*. Some participating states require separate notification that you are filing in this manner. It is your responsibility to contact the appropriate states for further information.

.07 The appropriate state code should be entered for those documents which meet that state's filing requirements. *It is the filer's responsibility* to determine the state code to be used and to obtain the filing requirements from the appropriate state(s).

.08 If you meet all of the requirements for this program, you *must* provide the state totals from the "K" record on a separate Form 4804, Transmittal of Information Returns on Magnetic Media (or Form 4802, Multiple Payer Transmittal For Magnetic Media Reporting) or computer generated substitute for each state, *or* you must include a listing which identifies each state and the "K" record totals for each.

.09 If you have met *ALL* of the above conditions:

(a) You must submit all records using 360 positions which indicate the appropriate coding related to this program.

(b) The "C" record *must* be followed by a "K" Record for each state. The "K" record indicates the number of payees (different TINs) being reported to each particular state.

(c) Payment amount totals and the

valid participating state code must be included in the state totals "K" Record. Refer to Part B, Sec. 7, for a description of the "K" Record.

(d) The "K" record is followed by an end of transmission "F" Record (if this is the last record of the entire file).

.10 Only those states listed in Table 1 below will receive informat from IRS. *It is the filer's responsib to file information returns with st that do not participate in this progr*

TABLE 1. PARTICIPATING STATES AND THEIR CODES

State	Code	State	Code	State	Cod
Alabama	01	Iowa	19	New York	3
Arizona	04	Kansas	20	North Carolina	3
Arkansas	05	Maine	23	North Dakota	3
California	06	Massachusetts	25	Oregon	4
Delaware	10	Minnesota	27	South Carolina	4
District of Columbia	11	Mississippi	28	Tennessee	4
Georgia	13	Missouri	29	Wisconsin	5
Hawaii	15	Montana	30		
Idaho	16	New Jersey	34		
Indiana	18	New Mexico	35		

11. To simplify filing, several of the participating states have provided lists of their information return reporting requirements (see Table 2). This cumulative list is for information purposes only and represents dollar criteria. For complete information on s filing requirements, contact the app priate state tax agencies.

TABLE 2. DOLLAR CRITERIA

STATE	1099-R	1099-DIV	1099-INT	1099-MISC	1099-PATR	1099-G	1099-OID	5
Alabama	1500	1500	1500	1500	1500	NR	1500	
Arizona[a]	300	300	300	300	300	300	300	
Arkansas	2500	100	100	2500	2500	2500	2500	
District of Columbia[b]	600	600	600	600	600	600	600	
Hawaii	600	10	10 [c]	600	10	all	10	
Idaho	600	10	10	600	10	10	10	
Iowa	1000	100	1000	1000	1000	1000	1000	
Minnesota	600	10	10 [d]	600 [e]	10	10	10	
Missouri	NR	NR	NR	1200 [f]	NR	NR	NR	
Montana	600	10	10	600	10	10	10	
New Jersey	1000	1000	1000	1000	1000	1000	1000	
New York	600	NR	600	600 [g]	NR	600	NR	
North Carolina	100	100	100	600	100	100	100	
Oregon	600 [h]	10	10	600	10	10	10	
Tennessee	NR	25	25	NR	NR	NR	NR	
Wisconsin	500	100	100	100	100	NR	NR	

NR—No filing requirement.

Footnotes:

a. These requirements apply to individuals and business entities.

b. Amounts are aggregates of several types of income from the same payroll.

c. State regulation changing filing requirement from $600 to $10 is pending.

d. $10.01 for Savings and Loan Associations and Credit Unions.

e. $600.01 for Rents and Royalties.

f. Aggregate both types of returns. The state would prefer those returns filed with respect to non-Missouri residents to sent directly to the state agency.

g. Aggregate of several types of income.

h. Return required for state of Oregon residents only.

i. Same as Federal requirements for this type of return.

*NOTE: Filing requirements for any state not shown on the above chart are the same as the Federal requirement.

SEC. 15. DEFINITIONS OF TERMS

Element	Description
b	Denotes a blank position. Enter blank(s) when this symbol is used (do *not* enter the letter "b"). This appears in numerous areas throughout the record descriptions.
Coding Range	Indicates the allowable codes for a particular type of statement.
EIN	Employer Identification Number that has been assigned by IRS to the reporting entity.
Excess Golden Parachute Payment	Parachute payments (also called "golden parachutes") are certain payments in the nature of compensation which corporations make to key individuals, often in excess of their usual compensation, in the event that ownership or control of the corporation changes.
File	For purposes of this procedure, a file consists of all magnetic tape records submitted by a Payer or Transmitter.
Payee	Person(s) or organization(s) receiving payments from the Payer, or for whom an information return must be filed.
Payer	Person or organization, including paying agent, making payments or the person liable for filing an information return. The Payer will be held responsible for the completeness, accuracy and timely submission of magnetic tape files.
Special Character	Any character that is not a numeral, a letter or a blank.
SSA	Social Security Administration.
SSN	Social Security Number.
Taxpayer Identification Number (TIN)	May be either an EIN or SSN.
Transfer Agent (Paying Agent)	The transfer agent or paying agent is the entity who has been contracted or authorized by the payer to perform the services of paying and reporting backup withholding (Form 941). The payer must submit to IRS a Form 2678, Employer Appointment of Agent under Section 3504, which notifies IRS of the transfer agent relationship.
Transmitter	Person or organization preparing magnetic tape file(s). May be Payer or agent of Payer.
Transmitter Control Code (TCC)	A *five* character number assigned by IRS to the transmitter prior to actual filing on magnetic media. This number is inserted in the "A" Record of your files and *must* be present before the file can be processed. An application Form 4419 must be filed with IRS to receive this number. See Part A, Sec. 5. (Abbreviation for this term is TCC.)

SEC. 16. U.S. POSTAL SERVICE STATE ABBREVIATIONS

You *MUST* use the following U.S. Postal Service state abbreviations when developing the state code portion of address fields. (This table provides state abbreviations only and does not represent those states participating in the Combined Federal/State Program. For a list of states that participate in the Combined Federal/State Program, refer to Sec. 14.10.)

State	Code
Alabama	AL
Alaska	AK
Arizona	AZ
Arkansas	AR
California	CA
Colorado	CO
Connecticut	CT
Delaware	DE
District of Columbia	DC
Florida	FL
Georgia	GA
Hawaii	HI
Idaho	ID
Illinois	IL
Indiana	IN
Iowa	IA
Kansas	KS
Kentucky	KY
Louisiana	LA
Maine	ME
Maryland	MD
Massachusetts	MA
Michigan	MI
Minnesota	MN
Mississippi	MS
Missouri	MO
Montana	MT
Nebraska	NE
Nevada	NV
New Hampshire	NH
New Jersey	NJ
New Mexico	NM
New York	NY
North Carolina	NC
North Dakota	ND
Ohio	OH
Oklahoma	OK
Oregon	OR
Pennsylvania	PA
Rhode Island	RI
South Carolina	SC
South Dakota	SD
Tennessee	TN
Texas	TX
Utah	UT
Vermont	VT
Virginia	VA
Washington	WA
West Virginia	WV
Wisconsin	WI
Wyoming	WY

PART B. TAPE SPECIFICATIONS

SECTION 1. GENERAL

.01 The specifications contained in this part of the revenue procedure define the required format and contents of the records to be included in the tape file. These specifications must be adhered to unless deviations have been specifically granted by IRS in writing.

.02 In most instances, IRS will be able to process any compatible tape files. Compatible tape files must meet any one set of the following:

(a) 9 channel EBCDIC (Extended Binary Coded Decimal Interchange Code) with

(1) Odd Parity and

(2) A density of 800, 1600, or 6250 BPI.

(b) 9 channel ASCII (American Standard Coded Information Interchange) with

(1) Odd Parity and

(2) A density of 800, 1600, or 6250 BPI.

(c) 7 channel BCD (Binary Coded Decimal) with

(1) Either Even or Odd Parity and

(2) A density of 556 or 800 BPI. (The IRS will accept and process 7 channel tapes; however, 9 channel is preferred.

.03 All compatible tape files must have the following characteristics:

(a) Type of tape—0.5 inch (12.7 mm) wide, computer grade magnetic tape on reels of up to 2400 feet (731.52 m) within the following specifications:

(1) Tape thickness: 1.0 or 1.5 mils and

(2) Reel diameter: 10.5 inch (26.67 cm), 8.5 inch (21.59 cm), or 7 inch (17.78 cm).

(b) Interrecord Gap—3/4 inch.

.04 Payers who can substantially conform to these specifications, but who require some minor deviations, MUST contact the Magnetic Media Coordinator at the National Computer Center or the service centers. Under no circumstances may tapes deviating from the specifications in this revenue procedure be submitted without prior written approval from IRS. If you file under the Combined Federal/State Program, your files must conform totally to this revenue procedure.

.05 An external label must appear on each tape submitted for processing. The following information is needed:

(a) The transmitter's name.

(b) The five character Transmitter Control Code.

(c) The type of computer equipment that the data was prepared on.

(d) The type of tape drive utilized.

(e) Tape density.

(f) Track (e.g., 7 or 9).

(g) Parity (e.g., Odd or Even).

(h) Recording code (e.g., EBCDIC or ASCII).

(i) The tax year of the data (e.g., 1985).

(j) Document types (e.g., 1099 INT).

(k) The total number of payers (from the "F" record).

(l) The total number of payees (from the "C" record).

(m) The total number of reels in the file.

(n) A reel number assigned by the transmitter.

(o) The sequence of each reel (e.g., 001 of 008).

This information will assist IRS in processing the file or in locating a file, should the transmitter request that it be returned due to errors. IRS advises that special shipping containers not be used for transmitting data since it cannot be guaranteed that they will be returned.

SEC. 2. RECORD LENGTH

.01 The tape records defined in this revenue procedure may be blocked or unblocked, subject to the following:

(a) A block must not exceed 10,000 tape positions.

(b) A record must be a minimum of 200 positions and a maximum of 360 positions. *A FIXED RECORD OF 360 POSITIONS IS RECOMMENDED.* If you report as a Combined Federal/State filer, your lengths *must* be 360 for all records: A, B, C, K, and F. Use a "K" Record *only* if you are an approved Combined Federal/State filer.

(c) If the use of blocked records would result in a short block, all remaining positions of the block must be filled with 9s. Do not pad a block with blanks.

(d) All records except the Header and Trailer Labels, may be blocked.

(e) Records may not span blocks.

.02 A provision is made in the Payee "B" Records for special data entries. These entries are optional. If the field is utilized, it must be present on all Payee "B" Records. The field is intended to serve one or both of these purposes:

(a) Contain information required by state or local governments. Filers who wish to use this option for satisfying state or local reporting requirements should contact their state or local department of revenue for filing instructions. Also refer to Part A, Sec. 14.

(b) Facilitate making all records the same length.

SEC. 3. OPTIONS FOR FILING

For filing convenience, this revenue procedure contains two options for using Header Labels and Payer/Transmitter "A" Records. For the purposes of this revenue procedure the following conventions must be used.

Header Label:

1. Payers may use standard headers provided they begin with 1HDR, HDR1, VOL1, VOL2, UHL1 or "bLABEL".

2. Consist of a maximum of 80 positions.

3. Position 9 MUST NOT contain the letters A, B, C, F, or K.

Trailer Label:

1. Standard trailer labels may be used provided that they begin with 1EOR, 1EOF, EOR1, EOF1, EOV1 or EOV2.

2. Consist of a maximum of 80 positions.

Record Mark:

1. Special character used to separate blocked records on tape.

2. Can be written only at the end of a record or block.

3. For odd parity tapes, use BCD bit configuration 011010 ("A82").

Tape Mark:

1. Used to signify the physical end of the recording on tape.

2. For even parity, use BCD configuration 001111 ("8421").

3. May follow the header label and precede and/or follow the trailer label.

Option 1: When using this option, a correct Payer/Transmitter "A" Record, described in Sec. 4 below, is required as the first record on each file. The reel sequence number must appear in positions 3-5 of each "A" Record and must be incremented by 1 on each tape reel of the file after the first reel. Filers using this option *may have Header Labels* preceding the "A" Record, how-

ever, headers are not required

Option 2: *Requires a Header Label* as the first record on each reel. The Header Label must contain the reel sequence number and it must be incremented by 1 on each reel after the first reel. The "A" Record will contain the location of the reel sequence number in the Header Label. If your system generates a four digit reel sequence number, ignore the first digit when determining the location for the purposes of the "A" Record. This option requires a Trailer Label at the end of each reel.

Examples for Option 2 filing:

Example 1: If your Header Label reel sequence is four digits (e.g. 0001) and is in positions 28-31, enter "29" as the location in position 3 and 4 of the "A" Record and also enter an "X" in position 5 of the "A" Record.

Example 2: If your Header Label reel sequence is 3 digits (e.g. 001) and is in positions 10-12, enter "10" as the location in positions 3 and 4 of the "A"; Record and also enter an "X" in position 5 of the "A" Record.

SEC. 4. PAYER/TRANSMITTER "A" RECORD

.01 Identifies the payer and transmitter of the tape file and provides parameters for the succeeding Payee "B" Records. IRS computer programs rely on the absolute relationship between the parameters and data fields in the "A" Record and the data fields in the "B" Records to which they apply.

.02 The number of "A" Records appearing on a tape reel will depend on the number of payers and the different types of returns being reported. After the header label on the tape, the first record appearing in the file must be an "A" Record. For magnetic tape filing, the *actual* record lengths for the "A" and "B" Records must agree with whatever is entered in tape positions 28-30 and 31-33 of the "A" Record. A transmitter may include Payee "B" records for more than one payer on a tape reel; however, each GROUP of Payee "B" Records must be preceded by an "A" Record. A single tape reel may also contain different types of returns, but the types of returns *must* not be intermingled. A separate "A" Record is required for each type of return being reported. An "A" Record may be blocked with "B" Records; however, the initial record on a *file* must be an "A" Record. The IRS will accept an "A" Record after a "C" Record; but *RECORDS MAY NOT SPAN BLOCKS*. Do not begin any record at the end of a block and continue the same record into the next block.

RECORD NAME: PAYER/TRANSMITTER "A" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "A".
2	Payment Year	1	REQUIRED. Must be the right most digit of the year for which information is being reported. (e.g., if payments were made in 1985, enter "5"). Must be incremented each year.
3-5	Reel Sequence Number	3	REQUIRED. Use in the following manner depending on the filing option selected as described in SEC. 3. above: *Filing Option* — *Usage* Option 1 — Contains the reel sequence number of the file on which this Payer/Transmitter "A" Record resides. Format will be nnn. Option 2 — Contains the location of the reel sequence number in the Header Label of the file on which this Payer/Transmitter "A" Record resides. Format will be nnX.
6-14	Payer's Federal EIN	9	REQUIRED. Must be the *valid* 9-digit number assigned to the payer by IRS. DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROES.
15	Blank	1	REQUIRED. Enter blank.
16	Combined Federal/State Filer	1	REQUIRED. Enter the appropriate code from the table below. *Prior approval* is required. A Consent Form 6847 *must* be submitted to IRS before tax information will be released to the States. Refer to Part A, Sec. 14.11 for money criteria. Not all states participate in this Program. If the Payer/Transmitter is not participating in the Combined Federal/State Filing Program, enter blanks. (Refer to Part A, Sec. 14 for the requirements that *must* be met *prior* to actual participation in this program.) Forms **1098, 1099-A, 1099-B and W-2G cannot be filed on this Program.**

Tape Position	Field Title	Length	Description and Remarks
			Code — *Meaning* 1 — Participating in the Combined Federal/State Filing Program. blank — Not participating.
17	Type of Return	1	REQUIRED. Enter appropriate code from table below: *Type of Return* — *Code* 1098 — 3 1099-A — 4 1099-B — B 1099-DIV — 1 1099-G — F 1099-INT — 6 1099-MISC — A 1099-OID — D 1099-PATR — 7 1099-R — 9 5498 — L W-2G — W
18-26	Amount Indicators	9	REQUIRED. In most cases, the boxes or Amount Indicators on paper information returns correspond with the Amount Codes used to file on magnetic media; however, should you notice discrepancies, please disregard them and program according to this revenue procedure for your returns filed on magnetic media. The amount indicators entered for a given type of return indicate type(s) of payment(s) which were made. Example: If position 17 of the Payer/Transmitter "A" Record is "6" (for 1099-INT) and positions 18-26 are "123bbbbbb", this indicates that 3 payment amount fields are present in all of the following Payee "B" Records. The first payment amount field in the Payee "B" Record will represent Earnings from savings and loan associations, credit unions, bank deposits, bearer certificates of deposit, etc., the second will represent Amount of forfeiture, and the third will represent Federal income tax withheld. Enter the Amount Indicators in ASCENDING SEQUENCE, left justify, filling unused positions with blanks. For any further clarification of the Amount Indicator codes, you may contact the service center or National Computer Center Magnetic Media Coordinators listed in Part A, Sec. 13.
	Amount Indicators Form 1098-Mortgage Interest Statement (New Form)		For Reporting Mortgage Interest Received from Payer(s) on Form 1098: Amount Code — Amount Type 1 — Mortgage interest received from payer(s) 2 — Optional field for items such as real estate taxes or insurance paid from escrow.
	Amount Indicators Form 1099-A—Acquisition or Abandonment of Secured Property (New Form)		For Reporting the Acquisition or Abandonment of Secured Property on Form 1099-A: Amount Code — Amount Type 2 — Amount of debt outstanding

Tape Position	Field Title	Length	Description and Remarks
		3	Amount of debt satisfied
		4	Fair market value of property at acquisition or abandonment
	Amount Indicators Form 1099-B—Proceeds from Broker and Barter Exchange Transactions		For Reporting Payments on Form 1099-B:

Amount Code	Amount Type
2	Stocks, bonds, etc. (For Forward Contracts see NOTE below.)
3	Bartering
4	Federal income tax withheld
6	Profit (or loss) realized in 1985
7	Unrealized profit (or loss) on open contracts--12/31/84
8	Unrealized profit (or loss) on open contracts—12/31/85
9	Aggregate profit (or loss)

NOTE: The Payment Amount field associated with Amount Code 2 may be used to represent a loss when the reporting is for Forward Contracts. Refer to Payee "B" Record-General Field Descriptions, Payment Amount Fields, for instructions in reporting negative amounts.

Amount Indicators Form 1099-DIV—Dividends and Distributions

For Reporting Payments on Form 1099-DIV:

Amount Code	Amount Type
1	Gross dividends and other distributions on stock
2	Dividends qualifying for exclusion
3	Dividends not qualifying for exclusion
4	Federal income tax withheld
5	Capital gain distributions
6	Nontaxable distributions (if determinable)
7	Foreign tax paid
8	Cash liquidation distributions
9	Noncash liquidation distributions (Show fair market value)

Amount Indicators Form 1099-G—Certain Government Payments

For Reporting Payments on Form 1099-G:

Amount Code	Amount Type
1	Unemployment compensation
2	State or local income tax refunds
4	Federal income tax withheld
5	Discharge of indebtedness
6	Taxable grants
7	Agriculture payments

Amount Indicators Form 1099-INT—Interest Income

For Reporting Payments on Form 1099-INT:

Amount Code	Amount Type
1	Earnings from savings and loan associations,

Tape Position	Field Title	Length	Description and Remarks
			credits unions, bank deposits, bearer certificates of deposit, etc.
		2	Amount of forfeiture
		3	Federal income tax withheld
		4	Foreign tax paid (if eligible for foreign tax credit)
		5	U.S. Savings Bonds, etc.
	Amount Indicators Form 1099-MISC—Miscellaneous Income (See Notes 1, 2 and 3)		For Reporting Payments on Form 1099-MISC:
		Amount Code	Amount Type
		1	Rents
		2	Royalties
		3	Prizes and awards
		4	Federal income tax withheld
		5	Fishing boat proceeds
		6	Medical and health care payments
		7	Nonemployee compensation
		8	Direct sales "*indicator*" (see NOTE 1)
		9	Substitute payments in lieu of dividends or interest (see NOTE 2)

NOTE 1: Use Amount Code "8" to report *direct sales* of $5000 or more of consumer products on a buy-sell, deposit-commission, or other basis *for resale*. If *not* for resale, enter a "0" (zero) in tape position 4 of the Payee "B" Record. Please refer to the "B" Record Document Specific Code for clarification. The use of Amount Code "8" actually reflects an *indicator* of *direct sales* and not an actual payment amount or amount code. The corresponding payment amount field in the Payee "B" Record MUST be reflected as 0000000100. This does not mean that a payment of $1.00 was made or is being reported. The use of Amount Code "8" relates directly to tape position 4, Document Specific Code and Note 2 of the Payment Amount Field in the Payee "B" Record.

NOTE 2: Brokers are subject to a new reporting requirement for payments received after 1984. Brokers who transfer securities of a customer for use in a short sale must use Amount Code 9 of Form 1099-MISC to report the aggregate payments received in lieu of dividends or tax-exempt interest on behalf of a customer while the short sale was open. Generally, for substitute payments in lieu of dividends, a broker is required to file a Form 1099-MISC for each affected customer who is *not* an individual. Refer to the 1985 "Instructions for Form 1099 Series, 1098, 5498, and 1096" for detailed information. (The instructions are available from local IRS offices.)

NOTE 3: If you are reporting Excess Golden Parachute Payments, use paper forms 1099-MISC. Do not report Excess Golden Parachute Payments on magnetic media for tax year 1985. See Part A, Sec. 15 for a definition of an Excess Golden Parachute Payment.

	Amount Indicators Form 1099-OID—Original Issue Discount		For Reporting Payments on Form 1099-OID:
		Amount Code	Amount Type
		1	Total original issue discount (ratable) for the tax year covered by the return
		2	Stated interest (the regular interest paid on this obligation without regard to any original issue discount)
		3	Amount of forfeiture
		4	Federal income tax withheld

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
	Amount Indicators Form 1099-PATR—Taxable Distributions Received From Cooperatives		For Reporting Payments on Form 1099-PATR:

Amount Code	Amount Type
1	Patronage dividends
2	Nonpatronage distributions
3	Per-unit retain allocations
4	Federal income tax withheld
5	Redemption of nonqualified notices and retain allocations
6	Investment credit (See NOTE)
7	Energy investment credit (See NOTE)
8	Jobs credit (See NOTE)

NOTE: The amounts shown for Amount Indicators "6", "7" and "8" must be reported to the payee; however, since these amounts are not taxable, they need not be reported to IRS.

Amount Indicators Form 1099-R—Total Distributions from Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, Etc. (See NOTE)

For Reporting Payments on Form 1099-R:

Amount Code	Amount Type
1	Amount includable as income (add amounts in codes 2 and 3)
2	Capital gain (for lump-sum distributions only)
3	Ordinary income
4	Federal income tax withheld
5	Employee contributions to profit-sharing or retirement plans
6	IRA, SEP or DEC distributions
8	Net unrealized appreciation in employer's securities
9	Other

NOTE: For tax year 1985 reporting, coding is not provided to report to IRS, on magnetic media, any state income tax withheld.

Amount Indicators Form 5498—Individual Retirement Arrangement Information

For Reporting Payments on Form 5498:

Amount Code	Amount Type
1	Regular IRA, SEP or DEC contributions made in calendar year 1985 for tax year 1984 reporting
2	Rollover IRA, SEP or DEC contributions
3	Regular IRA, SEP or DEC contributions made in calendar year 1985 and 1986 for tax year 1985 reporting
4	Allocable life insurance cost included in code 3 for endowment contracts only

Tape Position	Field Title	Length	Description and Remarks
	Amount Indicators Form W-2G—Certain Gambling Winnings		For Reporting Payments on Form W-2G: Amount Code — Amount Type 1 — Gross winnings 2 — Federal income tax withheld 7 — Winnings from identical wagers
27	Blank	1	REQUIRED. Enter blank.
28-30	"A" Record Length	3	REQUIRED. Enter the number of positions used or that you have allowed for the "A" Record. For magnetic tape filing, the "actual" record length *must* agree with whatever you enter in this field.
31-33	"B" Record Length	3	REQUIRED. Enter the number of positions used or that you have allowed for the "B" Record. For magnetic tape filing, the "actual" record length *must* agree with whatever you enter in this field.
34	Blank	1	REQUIRED. Enter blank.
35-39	Transmitter Control Code (TCC)	5	REQUIRED. Enter the 5 character Transmitter Control Code assigned by IRS. See Part A, Sec. 15 for a definition of Transmitter Control Code (TCC). You must have a TCC to file *actual* data on this program.
40	Blank	1	REQUIRED. Enter blank.
41-80	First Payer Name	40	REQUIRED. Enter the name of the payer in the manner in which it is used in normal business. Any extraneous information must be deleted from the name line. Left justify and fill with blanks.
81-119	Second Payer Name	39	REQUIRED. The contents of this field are dependent upon the TRANSFER AGENT INDICATOR in position 120 of this record. If the Transfer Agent Indicator contains a "1", this field will contain the name of the Transfer Agent. If the Transfer Agent Indicator contains a "0" (zero), this field will contain either a continuation of the First Payer Name field or blanks. Left justify and fill unused positions with blanks. IF NO ENTRIES ARE PRESENT FOR THIS FIELD FILL WITH BLANKS. (See Sec. 15 for a definition of Transfer Agent.)
120	Transfer Agent Indicator	1	REQUIRED. Identifies the entity in the Second Payer Name field. (See Part A, Sec. 15 for a definition of Transfer Agent.) *Code* — *Meaning* 1 — The entity in the Second Payer Name field is the Transfer Agent. 0 (zero) — The entity shown is *not* the Transfer Agent (i.e. the Second Payer Name field contains either a continuation of the First Payer Name field or blanks).
121-160	Payer Shipping Address	40	REQUIRED. If the TRANSFER AGENT INDICATOR in position 120 is a "1" enter the shipping address of the Transfer Agent. Otherwise, enter the shipping address of the payer. Left justify and fill with blanks.

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
161-200	Payer City, State and ZIP Code	40	REQUIRED. If the TRANSFER AGENT INDICATOR in position 120 is a "1" enter the city, state and ZIP Code of the Transfer Agent. Otherwise, enter the city, state and ZIP Code of the payer. Left justify and fill with blanks.
201-280	Transmitter Name	80	REQUIRED. Enter the name of the transmitter in the manner in which it is used in normal business. The name of the transmitter *must* be constant through the entire file. Left justify and fill with blanks.
281-320	Transmitter Mailing Address	40	REQUIRED. Enter the mailing address of the transmitter. Left justify and fill with blanks.
321-360	Transmitter City, State and ZIP Code	40	REQUIRED. Enter the city, state, and ZIP Code of the transmitter. Left justify and fill with blanks.

SEC. 5. PAYEE "B" RECORD—GENERAL FIELD DESCRIPTIONS

.01 The Payee "B" Record contains the payment information from the individual statements. When filing information documents on tape(s), the format for the Payee "B" Records will vary in relation to the number of payment amount fields being reported. The number of payment amount fields will depend upon on the number of Payment Amount Indicator Codes used in positions 18-26 of the Payer/Transmitter "A" Record. For example, if you are reporting 1099-INT, position 17 of the Payer/Transmitter "A" Record will be coded with a "6". If the Amount Indicators used to report this interest are Amount Codes "1", "2", and "3", then tape positions 18-26 of the "A" Record will be coded "123bbbbbb" (b represents a *blank* position). To correspond with Amount Indicators "1", "2" and "3" of the "A" Record, the "B" Record will contain three payment amount fields. Tape positions 31-40 of the "B" Record will contain the payment amount to be reported for Amount Code "1" (earnings from savings and loan associations, credit unions, bank deposits, bearer certificates of deposits, etc.); tape positions 41-50 of the "B" Record would contain the payment amount to be reported for Amount Code "2" (amount of forfeiture); and tape positions 51-60 of the "B" Record would contain the payment amount to be reported for Amount Code "3" (Federal income tax withheld). The First Payee Name Line *must* begin immediately after the last payment amount *that is used*. In this example, the First Payee Name Line would begin in tape position 61.

.02 All records must be a fixed length. Records may be blocked or unblocked. Records may not span blocks. A block may not exceed 10,000 tape positions. DO NOT PAD A BLOCK WITH BLANKS. If the use of blocked records would result in a short block, all remaining positions of the block must be filled with 9s.

.03 All payee records *must contain correct payee name and address information* entered in the fields prescribed in this section. Any records containing an invalid TIN (SSN or EIN) and having no address data present will be returned for correction.

.04 IRS must be able to identify the surname associated with the TIN (SSN or EIN) furnished on a statement. The specifications below include a field in the payee records called "Name Control" in which the first four alphabetic characters of the payees' surname or last name are to be entered by the payers. The surname or last name should appear first in the First Payee Name Line of all Payee "B" Records; however, if your records have been developed using the first name first, IRS programs will accept this but, a blank must appear between the first and last name.

.05 If payers are unable to provide the first four characters of the surname, the Name Control Field may be left blank; however, compliance with the following will facilitate IRS computer programs in generating the Name Control.

(a) The surname of the payee whose TIN (SSN or EIN) is shown in the Payee "B" Record should always appear first. If however, you enter the first name first, you must leave a blank space between the first and last name.

(b) In the case of multiple payees, only the surname of the payee whose TIN (SSN or EIN) is shown in the Payee "B" Record, must be present in the First Payee Name Line. Surnames of any other payees in the record must be entered in the Second Payee Name Line.

.06 Provision is also made in these specifications for data entries required by state or local governments. This should minimize the Payer/Transmitter's programming burden should payers desire to report on tape to state or local governments. See Part A, Sec. 14, for the Combined Federal/State filing requirements.

.07 Those filers participating in the Combined Federal/State Filing Program *must* have 360 position records. Positions 359 and 360 in the Payee "B" Records *must* contain the appropriate state code for the state to receive the information. The file should also meet the money criteria described in Part A,

Sec. 14.11. Do not code for the states unless prior approval to participate has been granted by IRS. See Part A, Sec. 14 for a list of the valid participating state codes. *FORMS 1098, 1099-A, 1099-B AND W-2G CANNOT BE FILED UNDER THE COMBINED FEDERAL/STATE FILING PROGRAM.* Your files must meet all of the requirements specified in Part A, Sec. 14 in order to participate in this program.

RECORD NAME: PAYEE "B" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "B".
2–3	Payment Year	2	REQUIRED. Must be the last two digits of the year for which payments are being reported (e.g., if payments were made in 1985 enter "85"). Must be incremented each year.
4	Document Specific Code	1	REQUIRED for Forms 1099-R, 1099-MISC, 1099-G and W-2G. For *Form 1099-R*, enter the appropriate value for the Category of Total IRA Distribution. For *Form 1099-MISC*, enter the appropriate value for Direct Sales. For *Form 1099-G*, enter the year of income tax refund. For *Form W-2G* enter the Type of Wager. FOR ALL OTHER FORMS, ENTER BLANK.
	Category of Total Distribution (Form 1099-R only)		Use only for reporting on *Form 1099-R* to identify the Category of Total Distribution. Enter the applicable code from the table below. Code 7 below is *not required* for Amount Indicators 1, 2 and 3. A "0" (zero) is not a valid code for Form 1099-R.
			Category — *Code* Premature distribution (other than codes 2, 3, 4, or 5) — 1 Rollover — 2 Disability — 3 Death — 4 Prohibited transaction — 5 Other — 6 Normal IRA, SEP or DEC distributions — 7 Excess contributions refunded plus earnings on such excess contributions — 8
	Direct Sales (Form 1099-MISC only)		Use only for direct sales reporting on *Form 1099-MISC*. If sales to the recipient of consumer products on a buy-sell, deposit-commission, or any other basis for resale, have amounted to $5,000 or more ENTER "1". If not for resale, enter "0" (zero). If you are filing 1099-MISC, with an Amount Indicator of "8" in the "A" Record, you must enter a code "1" or "0" in this field. In Part B, Sec. 4, information concerning the direct sales indicator can be found under Amount Indicators, Form 1099-MISC, NOTE 1.
	Refund is for Tax Year (Form 1099-G only)		Use only for reporting the tax year for which the refund was issued. If the payment amount field associated with Amount Indicator 2, Income Tax Refunds, contains a refund, credit or offset that is attributable to an income tax that applies exclusively to income from a trade or business and is not of general application, then enter the ALPHA equivalent of the year of refund from the table below. Otherwise, enter the NUMERIC Year for which the Refund was issued.
			Year for which Refund was Issued — *Alpha Equivalent* 1 — A 2 — B 3 — C 4 — D

RECORD NAME: PAYEE "B" RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
			5 E 6 F 7 G 8 H 9 I 0 J
	Type of Wager (Form W-2G only)		Use only for reporting the Type of Wager on *Form W-2G*. *Category* — *Code* Horse Race Track (or Off Track Betting of a Horse Track nature) — 1 Dog Race Track (or Off Track Betting of a Dog Track nature) — 2 Jai-alai — 3 State Conducted Lottery — 4 Keno — 5 Casino Type Bingo. DO NOT use this code for any other type of Bingo winnings (i.e. Church, Fire Dept. etc.). — 6 Slot Machines — 7 Any other types of gambling winnings. This includes Church Bingo, Fire Dept. Bingo, unlabeled winnings, etc. — 8
5-6	Blank	2	REQUIRED. Enter blanks. (Reserved for IRS use.) Tape position 5 is used to indicate a corrected return. Refer to Part A, Sec. 10 for specific instructions on how to file corrected returns utilizing either magnetic media or paper forms.
7-10	Name Control	4	REQUIRED. Enter the first 4 letters of the surname of the payee. Surnames of less than four (4) letters should be left justified, filling the unused positions with blanks. Special characters and imbedded blanks should be removed. IF THE NAME CONTROL IS NOT DETERMINABLE BY THE PAYER, LEAVE THIS FIELD BLANK. A dash (—) or ampersand (&) are the only acceptable special characters.
11	Type of TIN	1	REQUIRED. This field is used to identify the Taxpayer Identification Number (TIN) in positions 12-20 as either an Employer Identification Number, a Social Security Number, or the reason no number is shown. Enter the appropriate code from the table below: *Type of TIN* — *TIN* — *Type of Account* 1 — EIN — A business or an organization 2 — SSN — An individual 9 — SSN — The payee is a foreign individual and not a U.S. resident blank — N/A — A Taxpayer Identification Number is required but unobtainable due to legitimate cause; e.g. number applied for but not received.
12-20	Taxpayer Identification Numbe	9	REQUIRED. Enter the valid 9-digit Taxpayer Identification Number of the payee (SSN or EIN, as appropriate). Where an identification number has been applied for but not received or where there is any other legitimate cause for not having an identification number, *enter blanks*.

Tape Position	Field Title	Length	Description and Remarks
			DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROES. Any record containing an invalid identification number in this field will be returned for correction.
21-30	Payer's Account Number for Payee	10	REQUIRED. Payer may use this field to enter the payee's account number. The use of this item will facilitate easy reference to specific records in the payer's file should any questions arise. DO NOT ENTER A TAXPAYER IDENTIFICATION NUMBER IN THIS FIELD. An account number can be any account number assigned by the payer to the payee (i.e., checking account, savings account, etc.). THIS NUMBER WILL HELP TO DISTINGUISH THE INDIVIDUAL PAYEE'S ACCOUNT WITH YOU AND THE SPECIFIC TRANSACTION MADE WITH THE ORGANIZATION, SHOULD MULTIPLE RETURNS BE FILED. This information will be particularly necessary if you need to file a corrected return. You are strongly encouraged to use this field. You may use any number that will help identify the particular transaction that you are reporting.
	Payment Amount Fields		The number of payment amounts is dependent upon and must agree with the number of Amount Indicators present in positions 18-26 of the "A" Record. *THE FIRST PAYEE NAME LINE MUST APPEAR IMMEDIATELY AFTER THE LAST PAYMENT AMOUNT INDICATED AS BEING USED.* For example, if you are reporting 1099-INT and you used only Amount Indicator "3" in the Payer/Transmitter "A" Record, then you will only use one ten position payment amount in the Payee "B" Record, right justified, and the First Payee Name Line will begin in position 41. If you use a record length of 360 positions and you used just one payment amount, enter blanks after the ZIP Code in the Payee Address field to arrive at a 360 length record. Each payment field that you allow for, or use, must contain 10 numeric characters (see following NOTE). Do not provide a payment amount field when the corresponding Amount Indicator in the Payer/Transmitter "A" Record is blank. Each payment amount must be entered in dollars and cents. Do not enter dollar signs, commas, decimal points, or *NEGATIVE PAYMENTS* (except those items that reflect a loss on Form 1099-B and must be negative overpunched in the units position). Example: If the Amount Indicators are reflected as "123bbbbbb", the Payee "B" Records must have only 3 payment amount fields. If Amount Indicators are reflected as "12367bbbb", the "B" Records must have only 5 payment amount fields. Payment amounts MUST be right-justified and unused positions MUST be zero-filled. NOTE 1: If any one payment amount exceeds "9999999999" (dollars and cents), as many SEPARATE Payee "B" Records as necessary to contain the total amount MUST be submitted for the Payee. NOTE 2: If you file 1099-MISC and use Amount Code "8" in the Amount Indicator field of the Payer/Transmitter "A" Record, you must enter 0000000100 in the corresponding Payment Amount Field. This will not represent an actual money amount; this is an amount *code*. (Refer to PART B, Sec. 4, NOTE 1, of the Amount Indicators, Form 1099-MISC, for clarification.)

RECORD NAME: PAYEE "B" RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
31-40	Payment Amount 1	10	This amount is identified by the indicator in position 18 of the Payer/Transmitter "A" Record. *This amount must always be present.*
Determine at this point the number of payment fields to be reported within the Payee "B" Record. This can be determined from the number of Amount Indicators appearing in positions 18-26 of the Payer/Transmitter "A" Record.			
41-50	Payment Amount 2	10	This amount is identified by the indicator in position 19 of the Payer/Transmitter "A" Record. If position 19 is blank, do not provide for this payment amount.
51-60	Payment Amount 3	10	This amount is identified by the indicator in position 20 of the Payer/Transmitter "A" Record. If position 20 is blank, do not provide for this payment amount.
61-70	Payment Amount 4	10	This amount is identified by the indicator in position 21 of the Payer/Transmitter "A" Record. If position 21 is blank, do not provide for this payment amount.
71-80	Payment Amount 5	10	This amount is identified by the indicator in position 22 of the Payer/Transmitter "A" Record. If position 22 is blank, do not provide for this payment amount.
81-90	Payment Amount 6	10	This amount is identified by the indicator in position 23 of the Payer/Transmitter "A" Record. If position 23 is blank, do not provide for this payment amount.
91-100	Payment Amount 7	10	This amount is identified by the indicator in position 24 of the Payer/Transmitter "A" Record. If position 24 is blank, do not provide for this payment amount.
101-110	Payment Amount 8	10	This amount is identified by the indicator in position 25 of the Payer/Transmitter "A" Record. If position 25 is blank, do not provide for this payment amount.
111-120	Payment Amount 9	10	This amount is identified by the indicator in position 26 of the Payer/Transmitter "A" Record. If position 26 is blank, do not provide for this payment amount.
THE NEXT 160 POSITIONS MUST BEGIN IMMEDIATELY AFTER THE LAST PAYMENT AMOUNT FIELD INDICATED AS BEING USED. THE NUMBER OF PAYMENT AMOUNT FIELDS IS DETERMINED BY THE NUMBER OF AMOUNT INDICATORS IN POSITIONS 18-26 OF THE PAYER/TRANSMITTER "A" RECORD. (See PART B, Sec. 5.01 for an example.)			
	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear immediately after the last payment amount indicated as being *used*. Do not enter *address* information in this field. If you use all payment amounts, the first Payee Name Line will begin in tape position 121. Enter the name of the payee whose Taxpayer Identification Number appears in positions 12-20 above. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose Taxpayer Identification Number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number provided in positions 12-20 above. Do not enter address information in this

Tape Position	Field Title	Length	Description and Remarks
			field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
THE FOLLOWING FIELD DEFINITIONS DESCRIBE PAYEE "B" RECORD POSITIONS FOLLOWING PAYEE CITY, STATE AND ZIP CODE FOR EITHER (1) FORMS 1098, 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 1099-R AND 5498 *OR* (2) FORM 1099-A *OR* (3) FORM 1099-B *OR* (4) Form W-2G.			
(1) FORMS 1098, 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 1099-R and 5498 NEXT FIELD AFTER PAYEE CITY, STATE AND ZIP CODE:			
-358	Special Data Entries		REQUIRED. This portion of the Payee "B" Record may be used to record information for state or local government reporting or for other purposes. Payers should contact their state or local revenue departments for their filing requirements. The Special Data Entries will begin in positions 201, 211, 221, 231, 241, 251, 261, 271 or 281 depending on the number of payment amounts used in the record. Special Data Entries may be used to make all records the same length; however, the record may not exceed 360 positions. If this field is not utilized, ENTER BLANKS.
359-360	State Code	2	REQUIRED. If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, SEC. 14.10. For those states NOT participating in this program or for Form 1098, ENTER BLANKS
(2) FORM 1099-A (For detailed explanations of the following fields, see 1985 "Instructions for Form 1099 Series, 1098, 5498, and 1096," available at local IRS offices). NEXT FIELD AFTER PAYEE CITY, STATE AND ZIP CODE:			
-281	Blank	1	REQUIRED. Enter blanks.
282-287	Lender's Date of Acquisition or Abandonment	6	REQUIRED *FOR FORM 1099-A ONLY*. Enter the date of your acquisition of the secured property or the date you first knew or had reason to know that the property was abandoned in the format MMDDYY. DO NOT ENTER HYPHENS OR SLASHES.
288	Liability Indicator	1	REQUIRED *FOR FORM 1099-A ONLY*. Enter the appropriate indicator from table below:

RECORD NAME: PAYEE "B" RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
			Indicator — *Usage* 1 — Borrower is personally liable for repayment of the debt. Blank — Borrower is *not* liable for repayment of the debt.
289-325	Description	37	REQUIRED *FOR FORM 1099-A ONLY*. Enter a brief description of the property. For example, for real property, enter the address, section, lot and block. For personal property, enter the type, make and model (e.g., Car-1985 Buick Regal or Office Equipment, etc.).
326-360	Blank	35	REQUIRED. Enter blanks.

(3) FORM 1099-B (For detailed explanations of the following fields, see 1985 "Instructions for Form 1099 Series, 1098, 5498, and 1096," available at local IRS offices).

NEXT FIELD AFTER PAYEE CITY, STATE AND ZIP CODE:

−317	Blank		REQUIRED. Enter blanks.
318	Date of Sale Indicator	1	REQUIRED *FOR FORM 1099-B ONLY. Enter appropriate indicator from table below:* *Indicator* — *Usage* S — Date of Sale is the actual settlement date blank — Date of Sale is the trade date or this is an aggregate transaction
319-324	Date of Sale	6	REQUIRED *FOR FORM 1099-B ONLY*. Enter the trade date or the actual settlement date of the transaction in the format MMDDYY. Enter blanks if this is an aggregate transaction. DO NOT ENTER HYPHENS OR SLASHES
325-332	CUSIP No.	8	REQUIRED *FOR FORM 1099-B ONLY*. Enter the CUSIP (Committee on Uniform Security Identification Procedures) number of the items reported for Amount Indicator "2" (Stocks, bonds, etc.). Enter blanks if this is an aggregate transaction. Enter "0" (zeros) if the number is not available. For CUSIP numbers with more than 8 characters, supply the *first* 8.
333-358	Description	26	REQUIRED *FOR FORM 1099-B ONLY*. Enter a brief description of the item or services for which the proceeds are being reported. If fewer than 26 characters are required, left justify and fill unused positions with blanks. For regulated futures contracts, enter the customer account number. Enter blanks if this is an aggregate transaction.
359-360	Blank	2	REQUIRED. Enter blanks.

(4) FORM W-2G (For detailed explanations of the following fields see Form W-3G, Transmittal of Certain Information Returns, available at local IRS offices).

NEXT FIELD AFTER PAYEE CITY, STATE AND ZIP CODE:

−292	Blank		REQUIRED. Enter blanks.
293-298	Date Won	6	REQUIRED *FOR FORM W-2G ONLY*. Enter the date of the winning event in MMDDYY format. This is not the date the money was paid, if paid after the date of the race (or game). DO NOT ENTER HYPHENS OR SLASHES.
299-313	Transaction	15	REQUIRED *FOR FORM W-2G ONLY*. The ticket number, card

RECORD NAME: PAYEE "B" RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
			number (and color, if applicable), machine serial number or any other information that will help identify the winning transaction.
314-318	Race	5	REQUIRED *FOR FORM W-2G ONLY*. The race (or game) applicable to the winning ticket.
319-323	Cashier	5	REQUIRED *FOR FORM W-2G ONLY*. The initials of the cashier and/or the window number making the winning payment.
324-328	Window	5	REQUIRED *FOR FORM W-2G ONLY*. The location of the person paying the winnings.
329-343	First ID	15	REQUIRED *FOR FORM W-2G ONLY*. The first identification number of the person receiving the winnings.
344-358	Second ID	15	REQUIRED *FOR FORM W-2G ONLY*. The second identification number of the person receiving the winnings.
359-360	blank	2	REQUIRED. Enter blanks.

SEC. 6. END OF PAYER "C" RECORD

.01 The Control Total fields have been expanded from 12 to 15 positions. Adjust your programs accordingly.

.02 The End of Payer "C" Record is a summary record for a Type of Return for a given payer. It *MUST* be the same length as the "B" Records in the payer's file.

.03 The "C" Record will contain the totals of the payment amount fields and the payees filed by a given payer. The "C" Record must be written after the last payee record for each Type of Return for a given payer. For each "A" Record on the file, there must be a corresponding "C" Record.

.04 Payers/Transmitters must verify the accuracy of the totals in the "C" Record and must enter the totals on the transmittal, Form 4804, which will accompany the shipment.

RECORD NAME: END OF PAYER "C" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "C".
2-7	Number of Payees	6	REQUIRED. Enter the total number of payees ("B" Records) covered by the preceding Payer/Transmitter "A" Record. Right justify and zero fill.
8-22	Control Total 1	15	REQUIRED. Please note that all Control Total fields have been expanded from 12 to 15 positions. Enter accumulated totals from Payment Amount 1. Right justify and zero fill each Control Total amount. IF LESS THAN NINE AMOUNT FIELDS ARE BEING REPORTED, ZERO FILL UNUSED CONTROL TOTAL FIELDS.
	Control Total 2 through Control Total 9 are OPTIONAL. If any corresponding Payment Amount fields are present in the Payee "B" Records, accumulate into the appropriate Control Total field. ZERO FILL UNUSED CONTROL TOTAL FIELDS. Please note that all Control Total fields have been expanded from 12 to 15 positions.		
23-37	Control Total 2	15	
38-52	Control Total 3	15	
53-67	Control Total 4	15	
68-82	Control Total 5	15	
83-97	Control Total 6	15	
98-112	Control Total 7	15	
113-127	Control Total 8	15	
128-142	Control Total 9	15	
143-360	Blank	218	REQUIRED. Enter blanks.

SEC. 7. STATE TOTALS "K" RECORD

.01 The Control Total fields have been expanded from 12 to 15 positions. Adjust your programs accordingly.

.02 The State Totals "K" Record is a summary for a given payer and a given state in the Combined Federal/State Filing Program, used ONLY when State Reporting approval has been granted. *IT MUST BE 360 POSITIONS IN LENGTH.*

.03 The "K" Record will contain the totals of the payment amount fields and the payees filed by a given payer for a given state. The "K" Record(s) must be written after the "C" Record for the related "A" Record.

.04 There MUST be a separate "K" Record for *each state* being reported.

.05 Refer to Part A, Sec. 14 for the requirements and conditions that must be met to file on this Program.

RECORD NAME: STATE TOTALS "K" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "K".
2-7	Number of Payees	6	REQUIRED. Enter the number of payees (different TINs) being reported to this state. Right justify and zero fill.
8-22	Control Total 1	15	REQUIRED. Please note that all Control Total fields have been expanded from 12 to 15 positions. Enter accumulated total from Payment Amount 1. Right justify and zero fill each Control Total amount. IF LESS THAN NINE AMOUNT FIELDS ARE BEING REPORTED, ZERO FILL UNUSED CONTROL TOTAL FIELDS.
	Control Total 2 through Control Total 9 are OPTIONAL. If any corresponding Payment Amount fields are present in the Payee "B" Records, accumulate into the appropriate Control Total field. ZERO FILL UNUSED CONTROL TOTAL FIELDS. Please note that all Control Total fields have been expanded from 12 to 15 positions.		
23-37	Control Total 2	15	
38-52	Control Total 3	15	
53-67	Control Total 4	15	
68-82	Control Total 5	15	
83-97	Control Total 6	15	
98 112	Control Total 7	15	
113-127	Control Total 8	15	
128-142	Control Total 9	15	
143-358	Reserved	216	REQUIRED. Reserved for IRS use. Enter blanks.
359-360	State Code	2	REQUIRED. Enter the code for the state to receive the information.

SEC. 8. END OF TRANSMISSION "F" RECORD

.01 The "F" Record is a summary of the number of payers and tapes in the entire file.

.02 This record should be written after the last "C" Record (or "K" Record when applicable).

.03 Only a Tape Mark or a Tape Mark and Trailer Label may follow the "F" Record.

RECORD NAME: END OF TRANSMISSION "F" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "F".
2-5	Number of Payers	4	REQUIRED. Enter the total number of payers in the transmission. Right justify and zero fill.
6-8	Number of Reels	3	REQUIRED. Enter the total number of reels in transmission. Right justify and zero fill.
9-30	Zero	22	REQUIRED. Enter zeroes.
31-360	Blank	330	REQUIRED. Enter blanks.

Form **4419**
(Rev. July 1985)

Department of the Treasury — Internal Revenue Service

Application for Magnetic Media Reporting of Information Returns

IRS Use Only

OMB No. 1545-0387
Expires 7-31-88

1. Please fill in this form and send to

Internal Revenue Service Center

2. Name and address of organization *(street, city, State and ZIP code)*

3. Payment year for which you plan to begin reporting on magnetic media

4. Employer identification number

5. Kind of magnetic media you plan to submit *(check one)*

☐ Tape ☐ Cassette/Mini-Disk

☐ Disk ☐ Diskette

6. Person to contact about this request

Name:

Title:

Telephone number: *(include area code)*

7. **Documents To Be Reported**

Form	Estimated Volume		Form	Estimated Volume	
	Magnetic Media	Paper		Magnetic Media	Paper
☐ 1099-DIV			☐ 6248		
☐ 1099-INT			☐ W-4		
☐ 1099-MISC			☐ W-2G		
☐ 1099-OID			☐		
☐ 1099-R			☐		
☐ 1099-G			☐		
☐ 1099-PATR			☐		
☐ 1099-B			☐		
☐ 5498			☐		
☐ 8027			☐		
☐ 1042S			☐		

8. **Kind of equipment on which media will be prepared**

Main Frame *(all media types)*			Drive Unit *(all media)*	
Manufacturer	Model		Manufacturer	Model
Tape Only			**All Media Types**	
Width	Tracks ☐ 7 ☐ 9	Density	Recording code *(e.g., EBCDIC, BCD, or ASCII)*	

9. If your firm is acting as agent, please list the name and employer identification number of each payer on a separate sheet and attach it to this application.

10. **Person responsible for preparation of tax reports**	Name *(type or print)*	Title
	Signature	Date

See back of this form for Paperwork Reduction Act Notice.

Form **4419** (Rev. 7-85)

Instructions for Form 4419

Payers or agents who decide to file information returns on magnetic media must complete Form 4419 to receive authorization for filing. Please be sure to complete all appropriate blocks as explained in the following instructions:

Block 2

Enter the name and complete address of the person or organization that will prepare and submit the magnetic media.

Block 3

Show the tax *(payment)* year for which you intend to begin filing information returns on magnetic media.

Block 5

Check the kind of magnetic media you plan to submit. If you plan to submit more than one kind of magnetic media, you should complete a separate application for each kind.

Block 7

Check the boxes next to all of the information returns you file with the Internal Revenue Service.

a. **Magnetic media column**: Enter the total number of individual information returns to be reported on magnetic media *(an estimate is acceptable)*.

b. **Paper column**: Enter the total number of individual information returns to be reported on paper if not all returns will be filed in magnetic media form *(an estimate is acceptable)*.

Block 9

If your firm is preparing information returns on magnetic media for payers other than itself, attach to your application a list of the names and employer identification numbers of the payers. If you add or delete any payers from your file, you *must* submit an updated list of payers.

Block 10

The form must be signed and dated by an official of the company or organization requesting authorization to report on magnetic media.

Filing your application

1. Mail the completed application and any attached lists to the Internal Revenue Service Center at the address shown in BLOCK 1

2. When we receive your application, we will review it. If it is acceptable, we will send you an authorization letter within 30 days. Do not submit magnetic media until you receive an authorization letter.

3. We encourage new filers to submit test data on magnetic media for review before the filing season. If you want to submit test data, contact the magnetic media coordinator where you file your application.

4. Your authorization will be valid as long as the magnetic media submitted conforms to the specifications of the applicable revenue procedures. However, a new application is required if:

a. filing is discontinued and then resumed, or

b. there is any change in the equipment listed on the application.

Paperwork Reduction Act Notice

We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that the magnetic media you are using will be compatible with our processing equipment. The information is also used to more efficiently schedule and manage its processing in the service centers. You are required to give us this information if you want to file your returns on magnetic media.

26 CFR 601.602: Tax forms and instructions. (Also Part I, Section 1445)

Rev. Proc. 85-41

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide the procedures to be followed to obtain a withholding certificate for purposes of sections 1.1445-3T and 1.1445-6T of the Temporary Income Tax Regulations concerning withholding on dispositions by foreign persons of United States (U.S.) real property interests.

SEC. 2. BACKGROUND

The Tax Reform Act of 1984, section 129, 1984-3 (Vol. 1) C.B. 163, added section 1445 to the Internal Revenue Code as a means of enforcing the tax imposed pursuant to section 897 on dispositions by foreign persons of investments in U.S. real property. Section 1445(a) provides that a transferee of a U.S. real property interest from a foreign person must deduct and withhold a tax equal to 10 percent of the amount realized by the foreign person on the disposition. Section 1445(b) provides several exceptions to this requirement, including an exemption from withholding for persons who purchase property for use as a residence for $300,000 or less. Other exemptions under section 1445(b) include cases where the transferor furnishes an affidavit of nonforeign status, where the property transferred is stock that is regularly traded on an established securities market, and where a statement is obtained from the Internal Revenue Service that excuses withholding. Similarly, section 1445(c) provides that the amount required to be withheld can be reduced pursuant to a determination by the Service of the transferor's maximum tax liability upon the disposition. Sections 1.1445-3T and 1.1445-6T of the temporary regulations provide rules concerning the issuance by the Service of a withholding certificate that reduces or eliminates withholding. This revenue procedure provides additional guidance concerning applications for withholding certificates.

SEC. 3. WITHHOLDING CERTIFICATES—IN GENERAL

.01 *Purpose of Withholding Certificate.* Withholding under section 1445 may be reduced or eliminated pursuant to a withholding certificate issued by the Service in accordance with the rules set forth in this revenue procedure. A withholding certificate may be issued by the Service in cases where reduced withholding is appropriate, where the transferor is exempt from U.S. tax, or where an agreement for the payment of tax is entered into with the Service. A withholding certificate that is obtained prior to a transfer notifies the transferee that no withholding is required, or that reduced withholding is required. A withholding certificate that is obtained after a transfer has been made may authorize a normal refund or an early refund. See section 1.1445-3T(f) of the temporary regulations. A withholding certificate issued pursuant to the provisions of this revenue procedure serves to fulfill the requirements, as applicable, of section 1445(b)(4) concerning qualifying statements, section 1445(c)(1) concerning the transferor's maximum tax liability, or section 1445(c)(1) concerning the transferor's maximum tax liability, or section 1445(c)(2) concerning the Secretary's authority to prescribe reduced withholding.

.02 *Limited Effect of a Withholding Certificate.* A withholding certificate serves only to adjust withholding obligations to correspond as closely as possible to the probable tax liability arising out of a transfer. Therefore, all determinations that are made by the Service in connection with the issuance of a withholding certificate apply solely for the limited purpose of determining withholding obligations under section 1445 and do not necessarily represent the Service's final view with respect to any substantive issue that may arise in connection with a transfer. Similarly, the Service's acceptance in connection with the issuance of a withholding certificate of any evidence provided or any representation made by a taxpayer is made only for that purpose, is not binding for any other purpose, and does not constitute a final determination of the truth or accuracy of any such evidence or representation.

.03 *Types of Withholding Certificates available.* Pursuant to section 1.1445-3T of the temporary regulations, a withholding certificate may be issued on the basis of any of the following:

1 A determination by the Service that reduced withholding is appropriate because either:

(a) The amount otherwise required to be withheld would exceed the transferor's maximum tax liability; or

(b) Withholding of a reduced amount would not jeopardize collection of the tax;

2 The exemption from U.S. tax of all gain realized by the transferor; or

3 An agreement for the payment of tax providing security for the tax liability, entered into by the transferee or transferor.

SEC. 4. APPLICATIONS FOR WITHHOLDING CERTIFICATES

.01 *General rules.* An application for a withholding certificate must be submitted in duplicate to the Director, Foreign Operations District; Attn: FOD:666; 1325 K Street, N.W.; Washington, DC 20225. Either a transferee or a transferor may apply for a withholding certificate, but only a transferor may apply for a blanket withholding certificate. The Service ordinarily will act upon an application not later than the 90th day after its receipt. However, in the case of an application for a certificate described in section 4.036 below, and in unusually complicate cases, the Service may be unable to provide a withholding certificate by the 90th day. In such a case the Service will notify the applicant by the 45th day after receipt of the application that additional processing time will be necessary. The Service's notice may request additional information or explanation concerning particular aspects of the application and will provide a target date for final action (contingent upon the applicant's timely submission of any requested information). If an application for a withholding certificate is submitted at least 30 days prior to the date of a transfer, and on the date of the transfer the application remains pending with the

Service, then the amount required to be withheld by the transferee is not required to be reported and paid over immediately. Instead, that amount (or such other amount as is appropriate) must be reported and paid over by the 10th day following the Service's final determination with respect to the application for a withholding certificate.

.02 *Required signatures.* An application for a withholding certificate must be signed by a responsible officer in the case of a corporation, by a general partner in the case of a partnership, by a trustee, executor, or equivalent fiduciary in the case of a trust or estate, and, in the case of an individual, by the individual himself or herself. In addition, an application may be signed by an agent authorized to do so by a general or specific power of attorney. Form 2848 may be used for this purpose. The person signing the application must verify under penalties of perjury that all representations made in connection with the application are true, correct, and complete to the best of that person's knowledge and belief. To the extent that an application is premised in whole or in part on information provided by another party to the transaction, this information is to be supported by a written verification attached to that application signed under penalties of perjury by the party to whom it pertains. The application must follow the format set forth in section 4.04 below.

.03 *Categorizing of applications.* To facilitate the processing of applications for withholding certificates, this revenue procedure divides all applications into six basic categories, as follows:

1 Applications for withholding certificates based on a claim that the transfer is entitled to nonrecognition treatment or is exempt from tax;

2 Applications for withholding certificates based solely on a calculation of the transferor's maximum tax liability;

3 Applications for withholding certificates under the special installment sales rules of section 7 of this revenue procedure;

4 Applications for withholding certificates based on an agreement for the payment of tax with conforming security;

5 Applications for blanket withholding certificates under section 9 of this revenue procedure; and

6 Applications for withholding certificates on any other basis.

.04 *Format for application.* All applications for withholding certificates must provide the following information in paragraphs labelled to correspond with the numbers and letters set forth below. Place "N/A" in the relevant space if the information requested is not applicable to the application being submitted.

1 (a) State which category of section 3.03, above, describes the application;

(b) In the case of category 4 applications (agreement for the payment of tax with conforming security):

(1) State whether the proposed agreement secures (A) the transferor's maximum tax liability, or (B) the amount that would otherwise be required to be withheld; and

(2) State whether the proposed agreement and security instrument conform to the standard formats set forth in this revenue procedure.

2 (a) Provide the name, address, and identification number (if any) of the person applying for the withholding certificate.

(b) State whether the applicant is the transferee or transferor.

(c) provide the name, address, and identification number (if any) of all other transferees and transferors of the U.S. real property interest with respect to which the withholding certificate is sought.

3 Provide the following information concerning the U.S. real property interest with respect to which the withholding certificate is sought:

(a) Type of interest (that is, interest in real property, in associated personal property, or in a domestic U.S. real property holding corporation);

(b) The contract price;

(c) In the case of an interest in real property, its location and a general description of the property (for example, "10-story, 100 unit luxury apartment building"); and

(d) In the case of an interest in a U.S. real property holding corporation, the class or type and amount of the interest.

4 Provide full information concerning the basis for the issuance of the withholding certificate, in accordance with the rules of sections 4.05 through 4.10 below. Although the information to be included in this section of the application will necessarily vary from case to case, the rules set forth below provide general guidelines for the inclusion of appropriate information with respect to each category of application.

.05 *Information concerning category 1 applications (nonrecognition or exempt transfer).* If a withholding certificate is sought on the basis of a claim that the transaction is entitled to nonrecognition treatment or is exempt from U.S. taxation, provide the following:

1 A brief description of the transfer;

2 A brief summary of the law and facts supporting the claim of nonrecognition or exemption;

3 Evidence that the transferor has no unsatisfied withholding liability, as described in section 4.063; and

4 The most recent assessed value, for state or local property tax purposes, of the U.S. real property interest to be transferred, or other good faith estimate of its fair market value (no supporting evidence concerning the value of the property need be supplied)

.06 *Information concerning category 2 applications (determination of maximum tax liability).*

1 *In general.* If a withholding certificate is sought on the basis of a determination of the transferor's maximum tax liability, then information must be provided to establish the two elements of that liability: (a) the maximum tax that may be imposed on the disposition, and (b) the transferor's unsatisfied withholding liability. Paragraphs 4.062 and .063, below, provide guidelines for the furnishing of such information. for further information concerning the determination of the transferor's maximum tax liability, see section 1.1445-3T(c) of the temporary regulations.

2 *Maximum tax on disposition.* (a) The applicant must provide a calculation of the maximum tax that may be imposed on the disposition, including the following information:

(1) The amount to be realized by the transferor plus evidence confirming this

amount, such as a copy of the signed contract relating to the transfer;

(2) Adjusted basis of the property plus evidence confirming the basis claimed, such as schedules of depreciation for tax purposes;

(3) Amounts to be recaptured with respect to accelerated depreciation, investment tax credit, or other items subject to recapture;

(4) Maximum capital gain and/or ordinary income tax rates applicable to the transfer;

(5) Tentative tax owed;

(6) Amount of any increase or reduction of tax to which the transferor is subject, including any reduction to which the transferor is entitled under a provision of a U.S. income tax treaty as well as evidence supporting the adjustment claimed. See section 1.1445-3T(c)(2) of the temporary regulations.

(b) For purposes of calculating the maximum tax that may be imposed upon a disposition, unused credit carryovers shall not be taken into account, and net operating loss carryovers (NOL) (see section 172 of the Code) may be taken into account only if:

(1) The transferor claiming the NOL has been engaged in a trade or business in the U.S. during the three preceding tax years and has timely filed an income tax return for each of those years (copies of which should be attached);

(2) The claimed NOL has been reflected on previously-filed returns (No anticipated loss with respect to current-year operations may be considered);

(3) The claimed NOL is not currently the subject of an examination by or a dispute with the Service;

(4) The transferor agrees that if the amount of gain that the transferor claimed would be offset by the NOL exceeds the amount of the gain realized upon the subject disposition that is in fact offset by the claimed NOL when the transferor files its tax return for the current tax year, then the transferor will pay interest upon the excess of the amount that would have been withheld if the actual offset had been claimed in the application over the amount, if any, actually withheld, which interest will be computed;

(A) at the rates and in the manner prescribed by sections 6621 and 6622; and

(B) with respect to the period between the date on which withholding would otherwise have been required and the date on which payment is made (For purposes of determining whether gain realized on the subject disposition was in fact offset by the claimed NOL, the NOL is deemed to have offset first income from sources other than the disposition of U.S. real property interests, then gain from such dispositions with respect to which a withholding certificate was issued in the order in which such dispositions occurred);

(5) The claimed NOL has not previously been used to reduce withholding upon other dispositions of U.S. real property interests or to reduce the amount of any other obligation or liability under U.S. internal revenue laws;

(6) The NOL to be taken into account is computed without reference to any partnership losses that were recognized by the transferor with respect to any partnership interest of the transferor as a limited partner; and

(7) As part of the application, the transferor represents that:

(A) At least 80 percent of its gross income subject to U.S. taxation in the tax year of disposition will be derived from U.S. real property interests; and

(B) In calculating the maximum tax that may be imposed on the disposition, the application calculates the NOL in the manner prescribed by the provisions of this section 4.062(b), and the NOL is taken into account only to the extent permitted by such provisions.

3 *Transferor's unsatisfied withholding liability*. The applicant must provide a calculation of the transferor's unsatisfied withholding liability or evidence that it does not exist. That liability is the amount of any tax that the transferor was required to but did not withhold and pay over under section 1445 upon the acquisition of the subject U.S. real property interest or a predecessor interest. The transferor's unsatisified withholding liability is lincluded in the calculation of maximum tax liability so that such prior withholding liability can be satisfied by the transferee's withholding upon the current transfer. For further information see section 1.1445-3T(c)(3) of the temporary regulations. Evidence that the transferor has no unsatisfied withholding liability includes any one of the following items:

(a) Evidence that the trnasferor acquired the subject or predecessor real property interest prior to January 1, 1985;

(b) A copy of the Form 8288 that was filed by the transferor, and proof of payment of the amount shown due thereon, with respect to the transferor's acquisition of the subject or predecessor real property interest;

(c) A copy of a withholding certificate issued with respect to the transferor's acquisition of the subject or predecessor real property interest, plus a copy of Form 8288 and proof of payment with respect to any withholding required under that certificate;

(d) A copy of the nonforeign certification furnished by the person from whom the subject or predecessor U.S. real property interest was acquired, executed at the time of that acquisition;

(e) Evidence that the transferor purchased the subject or predecessor real property for $300,000 or less, and a statement, signed by the transferor under penalties of perjury, that the transferor purchased the property for use as a residence within the meaning of section 1.1445-2T(d)(1);

(f) Evidence that the person from whom the transferor acquired the subject or predecessor U.S. real property interest fully paid any tax imposed on that transaction pursuant to section 897;

(g) A copy of a notice of nonrecognition treatment provided to the transferor pursuant to section 1.1445-2T(d)(2) by the person from whom the transferor acquired the subject or predecessor U.S. real property interest; and

(h) A statement, signed by the transferor under penalties of perjury, setting forth the facts and circumstances that support the transferor's conclusion that no withholding was required under section 1445(a) with respect to the transferor's acquisition of the subject or predecessor real property interest.

.07 *Information concerning category 3 applications (installment sale)*. See section 7 of this revenue procedure.

.08 *Information concerning category 4 applications (agreement for the payment of tax with conforming security)*. If a withholding certificate is sought on the basis of an agreement for the pay-

ment of tax, the application must include:

1 Information establishing:

(a) the transferor's maximum tax liability, in accordance with section 4.06; or

(b) The amount otherwise required to be withheld pursuant to section 1445(a).

2 A signed copy of the agreement proposed by the applicant; and

3 A copy of the security instrument proposed by the applicant. For further information concerning agreements for the payment of tax and security instruments, see sections 5 and 6 of this revenue procedure and section 1.1445-3T.

.09 *Information concerning category 5 applications (blanket withholding certificate).* See section 9 of this revenue procedure.

.10 *Information concerning category 6 applications (non-standard applications).*

1 *Agreement for payment of tax with nonconforming security.* If the applicant seeks to enter an agreement for the payment of tax but wishes to provide a nonconforming type of security, the application must include:

(a) The information required by section 4.08 concerning category 4 applications;

(b) A description of the nonconforming security proposed by the applicant; and

(c) A memorandum of law and facts establishing that the proposed security is valid and enforceable and that it adequately protects the government's interest.

2 *Other non-standard applications.* An application for a withholding certificate not otherwise described in this revenue procedure must explain in detail the proposed basis for the issuance of the certificate and set forth the reasons justifying the issuance of a certificate on that basis.

.11 *Availability of records.* The applicant shall make available to the Director, Foreign Operations District, within the time prescribed by the Director all information that may be required by the Director in order to verify that representations relied upon by the Director in accepting the agreement are accurate, and that the obligations assumed by the applicant will be performed pursuant to the agreement. Failure to provide requested information promptly will usually result in rejection of the application. Instead of or in addition to such rejection, the Director, in his discretion, may also consider extension of an established target date for issuing a withholding certificate.

The parties shall agree that the review of books and records pursuant to the agreement shall not constitute an examination for purposes of section 7605(b) of the Code.

SEC. 5. AGREEMENT FOR THE PAYMENT OF TAX

.01 *In general.* The Service will issue a withholding certificate that excuses withholding or that permits a transferee to withhold a reduced amount if either the transferee or the transferor enters into an agreement for the payment of tax. An agreement for the payment of tax is a contract between the Service and any other person that consists of two necessary elements. Those elements are—

1 A contract between the Service and the other person, setting forth in detail the rights and obligations of each; and

2 A security instrument or other form of security acceptable to the Director, Foreign Operations District.

.02 *Contents of agreement—In general.* An agreement for the payment of tax must either provide adequate security for the payment of the tax in accordance with section 6 of this revenue procedure or provide for the payment of the tax through a combination of security and withholding of tax by the transferee. The agreement must cover an amount described in subdivision (a) or (b) of this paragraph.

(a) *Tax that would otherwise be withheld.* An agreement for the payment of tax may cover the tax that would otherwise be required to be withheld pursuant to section 1445(a). In addition to securing the amount computed pursuant to section 1445(a), the agreement must provide that the applicant will pay interest upon that amount, at the rates and in the manner, prescribed by sections 6621 and 6622, with respect to the period between the date on which the agreement is entered into and the date on which the transferor's payment of tax with respect to the disposition will be due. Interest and additions to tax with respect to the tax must also be secured. In most instances, payments of interest and additions to tax may be secured by the same agreement that secures payment of taxes. At the discretion of the Director, however, separate security agreements may be required.

(b) *Maximum tax liabilty.* An agreement for the payment of tax may provide for the payment of the transferor's maximum tax liability, determined in accordance with section 4.062 of this revenue procedure. The agreement must also provide for the payment of an additional amount equal to 25 percent of the amount determined under section 4.062. This additional amount secures the interest and additions to tax that would accrue between the date of a failure to file a return and pay tax with respect to the disposition, and the date on which the Service collects the tax upon that liability pursuant to the agreement.

.03 All agreements for the payment of tax will be between the Director, Foreign Operations District, and the applicant furnishing the security or personally guaranteeing payment of any tax later determined to be due. In addition, the Director may require as a signatory any other party deemed appropriate. The Director may require such other terms and conditions, or vary the format, as appropriate in the particular case, to provide adequate security.

.04 The agreement for the payment of tax should state the purpose and basis of the agreement. It should also recite any warranties or representations upon which the Director, Foreign Operations District, will be required to place material reliance in accepting the agreement.

.05 The agreement for the payment of tax must set forth in detail the obligations to be assumed and identify the nature of the security that is being offered. To the extent that the security is embodied in an instrument or document collateral to the agreement, such instrument or document must be incorporated by reference in the agreement.

.06 *Sample agreement.* The following sets forth the language of an agreement for the payment of tax that in most circumstances is acceptable to the Service:

1 This agreement is entered into pursuant to the provisions of section 1445 of the Internal Revenue Code (the "Code") and the regulations thereunder.

The signatories warrant that they are authorized under applicable law to make the agreements and undertake the actions and obligations specified herein.

2 ___ warrants that (s)he/it will make timely payment of any liability (including tax, penalties, interest, and additions to tax) that may become lawfully due and owing under the Code as a result of the diposition or distribution by ___ of the interest, or any part thereof, described in Exhibit(s) ___ [the "subject interest(s)"] giving rise to tax liability by reason of the operation of sections 871(b), 882, and/or 897 of the Code. The related security secures payment of such amounts. Security for the payment of such liability is provided in the amount of ___, in accordance with the requirements of section 1.1445-3T(e)(2) of the Temporary Income Tax Regulations. The computation of the proper amount of security to be provided is set forth in Exhibit ___ and such computation is hereby incorporated by reference.

3 The provisions of this agreement shall be construed as binding upon all signatories to this agreement, unless the intent to exclude any one or more signatories is clearly set forth in the provisions or is clearly implicit in the terms hereof.

4 The amount of each deposit of estimated tax that will be required with respect to the amount realized on the subject disposition may be collected by levy upon or recourse to the security as of the date following the date on which each such deposit is due (unless such deposit is timely made);

5 The entire amount of the liability may be collected by levy upon or recourse to the security at any time during the nine months following the date on which the payment of tax with respect to the subject disposition is due, subject to release of the security upon the full payment of the tax and any interest and penalties due. If the transferor requests an extension of time to file a return with respect to the disposition, then the Director may require that the term of the security instrument be extended until the date that is nine months after the filing deadline as extended.

6 The applicant shall make available to the Director within 30 days of a request from the Director all information that may be required by the Director in order to verify that representations relied upon by the Director in accepting this agreement are accurate, and that the obligations assumed by the applicant are performed purusant to this agreement.

7 The parties agree that the review of books and records pursuant to this agreement shall not constitute an examination for purposes of section 7605(b) of the Code.

8 Nothing in this agreement shall limit the Director from performing the obligations imposed upon or delegated to him under the law.

9 Upon the occurrence of any default by the applicant under the applicable provisions of this agreement, in addition to any and all other rights and remedies which the Director may then have hereunder, or under any other applicable law, or otherwise, the Director may reduce the claim to judgment, otherwise enforce the security interests by any available judicial procedure, and exercise any other rights and remedies the Director may have at law, or in equity, or otherwise, including, but not limited to, the right to apply toward payment of the obligations hereunder, without notice to the applicant, any sums which may then be held by the Director for said applicant.

10 For purposes of this agreement, the term "default" means a material misrepresentation of material fact or a failure to honor an obligation or warranty agreed to herein.

11 Except as otherwise provided in this agreement, no provision of this agreement shall be deemed to constitute a waiver of any right that any party may have to recover any amount in accordance with the laws, statutes, and regulations of the United States, nor shall any provision of the agreement be deemed to be an admission by any person, whether or not a party hereto, that such person is liable for any federal income tax, or, if a foreign corporation or nonresident alien, that such person is subject to the taxing jurisdiction of the United States, or if the Director, that the facts upon which this agreement is based are true and accurate.

12 This agreement and all of its terms and conditions shall inure to the benefit of, and be binding upon, the Director, and the applicant, and their respective successors and assigns.

13 All notices, instructions, and other communications ("Notices") required or permitted to be given, forwarded, or transmitted hereunder or necessary or convenient in connection herewith shall be in writing, shall be addressed either

To the Director: Director
Foreign Operations District
Attn: FOD:666
1325 K Street, N.W.
Washington, DC 20225

or

To [the applicant]: the applicant's address etc.],

and shall be deemed to have been duly given when delivered personally; or sent by first class U.S. mail (postage pre-paid, by registered or certified mail, return receipt requested); or sent by cable, telex, telegram, or facsimile transmission (for example, telecopier) and confirmed by letter mailed the same day to the party receiving the notice. Any notice sent by mail to or from a place outside the continental United States shall be sent by air mail. Any notice sent by cable, telegram, or telex may be addressed to any published cable, telegram, or telex address that the addressee may have specified by notice to all the signatories. Any signatory may change the address or addresses to which communications are to be directed to it by giving written notice of such change to the persons above specified in the manner provided above; provided, however, that [the applicant] may establish or change an address to which notices are to be directed only if the new address is the address of [the applicant] itself or the address of a person with power of attorney to act for [the applicant] with respect to the disposition or distribution described in paragraph 2.

14 This agreement may not be amended, modified, superseded, or cancelled, and none of the terms hereof may be waived, except by a written instrument executed by the Director and the other party or parties hereto sought to be charged thereby. In the case of a waiver of the breach of any term contained in this agreement in any one or

more instances, the waiver shall be neither deemed to be nor construed as a further or continuing waiver of any such breach or term or any other term contained in this agreement.

15 This agreement may be executed in any number of counterparts with all the counterparts together constituting one and the same agreement.

16 The term "Director" as used herein shall also include any successors in office, the Assistant Director, Foreign Operations District, and any and all agents or employees thereof duly authorized for the purpose.

17 This agreement shall not be binding upon any signatory hereto until it has been signed by the Director and the Director has received counterparts thereof duly executed by each of the signatories whose names appear at the foot of this agreement.

18 No provision of this agreement shall relieve any party or person of any obligation or liability under the internal revenue laws of the United States except as specifically provided in this agreement.

19 This agreement is made without prejudice to the assertion and/or collection of tax liabilities other than for any tax imposed by section 871(b)(1) or 882(a)(1) of the Code on any gain realized by the transferor on the disposition of the subject United States real property interest.

20 This agreement shall be governed, construed, and enforced in accordance with the laws of the United States of America and, where applicable, the laws of the State of [insert applicable local jurisdiction.]

21 It is agreed that nothing herein shall be construed to increase, decrease, or otherwise affect in any way the substantive tax liability of the taxpayer under any other provisions of the Code.

22 The Director will not, in part or in full, release, subordinate, or return the security held with respect to this agreement except upon the payment of any liability determined to be due or upon the deposit of an acceptable amount of estimated tax or upon a showing to the satisfaction of the Director that the liability is zero.

I accept this Agreement.	Under penalties of perjury, I declare that I have examined this Agreement, and related exhibits, schedules and statements, and to the best of my knowledge and belief it is true, correct and complete.
Signature	Signature of Signatory/Power of Attorney
Title Director, Foreign Operations District	

SEC. 6. SECURITY

.01 There are four major types of security acceptable to the Service. These are:

1 *Bond with surety or guarantor.* The Service may accept as security with respect to a transferor's tax liability a bond that is executed with a satisfactory surety or guarantor. Only the following persons may act as surety or guarantor for this purpose:

(a) A surety company holding a certificate of authority from the Secretary as an acceptable surety on Federal bonds, as listed in Treasury Department Circular No. 570, published annually in the Federal Register on the first working day in July and as supplemented from time to time thereafter;

(b) A person that is engaged within or without the U.S. in the conduct of a banking, financing, or similar business under the principles of section 1.864-4(c)(5) of the regulations, and that is subject to U.S. or foreign (local or national) regulation of such business, if that person is otherwise acceptable to the Service; and

(c) A person that is engaged within or without the U.S. in the conduct of an insurance business that is subject to U.S. or foreign (local or national) regulation, if that person is otherwise acceptable to the Service.

2 *Bond with collateral.* The Service may accept as security with respect to a transferor's tax liability a bond that is secured by acceptable collateral. All collateral must be deposited with a responsible financial institution acting as escrow agent, or, in the Service's discretion, with the Service. Only the following types of collateral are acceptable:

(a) Bonds, notes, or other public debt obligations of the U.S., in accordance with the rules of 31 CFR Part 225; and

(b) A certified, cashier's, or treasurer's check, drawn on an entity acceptable to the Service that is engaged within or without the U.S. in the conduct of a banking, financing, or similar business under the principles of section 1.864-4(c)(5) of the regulations and that is subject to U.S. or foreign (local or national regulation of such business.

3 *Letter of credit.* The Service may accept as security with respect to a transferor's tax liability an irrevocable letter of credit issued by an entity acceptable to the Service that is engaged within or without the U.S. in the conduct of a banking, financing, or similar business under the principles of section 1.864-4(c)(5) of the regulations and that is subject to U.S. or foreign (local or national) regulation of such business. However, the Director, Foreign Operations District, will accept a letter of credit from an entity that is not engaged in a trade or business in the U.S. only if such letter may be drawn on an advising bank within the U.S.

4 *Guarantee.* The Service may accept as security with respect to a corporate transferor's tax liability a guarantee of the payment of such liability. The Service will accept such a guarantee only if (a) the corporation providing the guarantee is a corporation, foreign or domestic, any class of the stock of which is regularly traded on an established securities market on the date of the transfer; and (b) the corporation providing the guarantee (1) is the transferor or (2) holds, directly or indirectly, more than 80 percent of the voting stock of the transferor or (3) is engaged in a trade or business within

the U.S.; and (c) has $25 million in gross assets in the U.S. in excess of the U.S. real property interest being disposed of.

5 *Other forms of security.* The Service may in unusual circumstances and at its discretion accept any additional form of security that it finds to be adequate.

.02 Listed below are sample forms of security instruments that in most circumstances are acceptable to the Service to be used when requesting a withholding certificate pursuant to section 1.1445-3T of the temporary regulations.

[BOND WITH SURETY/GUARANTOR

OBLIGATION. The undersigned, _____, the Guarantor(s), is (or if more than one, jointly and severally are) irrevocably held and firmly bound to pay the Internal Revenue Service the following portion of any tax (including any penalties, interest, and additions to tax) lawfully due and owing by any person listed below as a specified taxpayer as a result of the disposition or distribution of all or part of the subject interest in U.S. real property listed below as the subject interest(s):

CONDITIONS OF THIS OBLIGATION. The Internal Revenue Service may demand payment of the secured liability or any portion thereof at any time and for any reason. If the secured liability or requested portion is paid when requested by the Internal Revenue Service, then this Guarantee shall be released to the extent so paid, otherwise it shall remain in full force and effect until released in writing by the Internal Revenue Service.

SUBJECT INTEREST(S):

SPECIFIED TAXPAYER(S):

SIGNED, SEALED, AND DATED THIS ___ day of ___ 19 ___.

_____

Guarantor [SEAL]

_____

Guarantor [SEAL]

Corporate Guarantor

(Corporate Seal)

Attest:

By: _____ [Corporate Seal]

_____

Surety/Guarantor

_____ By: _____ [Corporate Seal]

Secretary Title

2 BOND WITH COLLATERAL

OBLIGATION. The undersigned, _____, the Guarantor(s), is (or if more than one, jointly and severally are) irrevocably held and firmly bound to pay the Internal Revenue Service the following portion of any tax (including any penalties, interest, and additions to tax) lawfully due and owing by any person listed below as a specified taxpayer as a result of the disposition or distribution of all or part of the subject interest in U.S. real property listed below as the subject interest(s):

SECURITY. The above-bound Guarantor(s), in order to more fully secure the Internal Revenue Service in the payment of the amount of this obligation hereby pledge(s) as security therefor the following collateral.

* * *

CONDITIONS OF THE OBLIGATION. The Internal Revenue Service may demand payment of the secured liability or any portion thereof at any time and for any reason. If the Guarantor(s) fail(s) to pay the amount requested by the Internal Revenue Service, the Director, Foreign Operations District, and his designates are authorized and empowered, in their sole discretion, in whole or in part, to exercise the power of attorney, contemporaneously executed and delivered, to collect, sell, transfer, or assign the above described security and apply the funds so received in full or partial satisfaction of any liability for taxes, interest, penalties, or additions to tax secured hereby. If the secured liability or portion requested is paid by the Guarantor(s) when requested by the Internal Revenue Service, then this security shall be released to the extent so paid; otherwise this obligation shall remain in full force and effect until released in writing by the Internal Revenue Service.

SUBJECT INTEREST(S):

SPECIFIED TAXPAYER(S):

SIGNED, SEALED, AND DATED THIS ___ day of ___19 ___.

_____

Guarantor [SEAL]

_____

Guarantor [SEAL]

_____

Corporate Guarantor

By _____

Title [Corporate seal]

(Corporate Seal)
Attest:

_____

Secretary

3 POWER OF ATTORNEY

I (we). . . . do hereby constitute and appoint the Director, Foreign Operations District, (and his/her designate) as attorney for me (us) and in my (our) name to collect, sell, assign, and transfer the following:

* * *

which has been deposited by me (us) as security for the faithful performance of my (our) bond, which is attached and incorporated by this reference, and I (we) agree that, in case of any default in the performance of any of the conditions and stipulations of the bond, my (our) said attorney shall have full power to collect said security or any part thereof, or to sell, assign, and transfer said security or any part thereof without notice, at public or private sale, or to transfer or assign to another for the purpose of effecting either public or private sale, free from any equity of redemption and without appraisal or valuation, notice and right to redeem being waived, and the proceeds of such sale for collection, in whole or in part to be applied to the satisfaction of the liability secured by the bond in such manner as may be deemed in the best interest of the United States, and I (we) further agree that the authority herein granted is irrevocable.

And for myself (ourselves), my (our several) administrators, executors, and assigns, I (we) hereby ratify and confirm whatever my (our) said attorney shall do by virtue of this power of attorney.

In witness whereof, I (we), herein above named, have executed this instrument and affixed my (our) seal this____day of _____, 19____

_____ [SEAL]

State of _____

County of _____ } ss

Before me, the undersigned, a notary public within and for the said county and State, personally appeared . . . . [Name(s) of Guarantor(s)], and acknowledged the execution of the foregoing power of attorney.

Witness my hand and notarial seal this____day of _____, 19____

[Notarial seal]

_____

Notary Public

My Commission expires_____

Corporation's power of attorney

4 POWER OF ATTORNEY

. . . . . , a corporation duly incorporated under the laws of the state of . . . . . and having its principal office in the city of . . . . . , State of . . . . . , in pursuance of a resolution of the Board of Directors, of said corporation, passed on the . . . . day of . . . . . , 19 . . . . , a duly certified copy of which resolution is hereto attached, does hereby constitute and appoint the Director, Foreign Operations District, (and his designates) as attorney for said corporation, for and in the name of said corporation, to collect or to sell, assign, and transfer the following:

* * *

which have been deposited by it as security for the faithful performance of the bond, a copy of which is attached, and which is incorporated by reference, and the undersigned agrees that, in case of any default in the performance of any of the conditions and stipulations of the bond, its said attorney shall have full power to collect said security or any part thereof, or to sell, assign, and transfer said security or any part thereof without notice, at public or private sale, or to transfer or assign to another for the purpose of effecting either public or private sale, free from any equity of redemption and without appraisal or valuation, notice and right to redeem being waived, and the proceeds of such sale for collection, in whole or in part to be applied to the satisfaction of the liability secured by the bond, in such manner as may be deemed in the best interest of the United States, and the undersigned further agrees that the authority herein granted is irrevocable.

And said corporation, hereby for itself, its successors and assigns, ratifies and confirms whatever its said attorney shall do by virtue of this power of attorney.

In witness whereof, the . . . . . , the corporation above named, by . . . . . (Name and title of officer), duly authorized to execute this instrument has caused the seal of the corporation to be hereto affixed this . . . day of. . . . . , 19. . . . . .

Attest:

_____ _____

(Corporate seal) Secretary

By _____

Title

State of _____

County of _____ } ss

Before me, the undersigned, a notary public within and for the said county and State, personally appeared _____ (name and title of officer), and for and in behalf of said _____, corporation, acknowledged the execution of the foregoing power of attorney.

Witness my hand and notarial seal this _____ day of _____ 19____

[Notarial seal]

_____

Notary Public

My Commission expires _____

5 LETTER OF CREDIT

Place: Cable Address:
Date:

IRREVOCABLE STANDBY LETTER OF CREDIT	All drafts must be marked: Drawn under credit no.	Advising bank reference to
Advising bank	For account of	
To beneficiary INTERNAL REVENUE SERVICE C/O DIRECTOR, FOREIGN OPERATIONS DISTRICT ATTENTION: COLLECTION DIVISION 1325 K Street, N.W. WASHINGTON, DC 20225		Amount Expiration date
		This refers to preliminary cable advice of this credit.

Gentlemen:

We hereby establish our irrevocable letter of credit in your favor available by your drafts drawn at SIGHT and accompanied by documents specified below: NONE

We hereby engage with you that all drafts drawn under and in compliance with the terms of this credit will be duly honored if drawn and presented for payment at this office on or before the expiration date of this credit. The advising bank is requested to notify the beneficiary without adding their confirmation. Sincerely yours, Authorized counter signature/ Authorized signature	Advising bank's notification Place, date, name, and signature of the advising bank

6 GUARANTEE

OBLIGATION. The undersigned, _____, the Guarantor(s), is (or if more than one, jointly and severally are) irrevocably held and firmly bound to pay the Internal Revenue Service the following portion of any tax (including any penalties, interest, and additions to tax) lawfully due and owing by any person listed below as a specified taxpayer as a result of any disposition or distribution taxable by reason of sections 871(b)(1), 882(a)(1), and/or 897 of the Code as to all or part of the subject interest in U.S. real property listed below as the subject interest:

CONDITIONS OF THIS OBLIGATION. The Internal Revenue Service may demand payment of the secured liability or any portion thereof at any time and for any reason. If the secured liability or requested portion is paid when requested by the Internal Revenue Service, then this Guarantee shall be released to the extent so paid, otherwise it shall remain in full force and effect until released in writing by the Internal Revenue Service.

SUBJECT INTEREST(S):

SPECIFIED TAXPAYER(s):

SIGNED, SEALED AND DATED THIS _____ day of _____.

_____

Guarantor [Seal]

_____

Corporate Guarantor

By: _____

[CORPORATE SEAL]

ATTEST:

_____

Secretary

SEC. 7. INSTALLMENT SALES

.01 *In general.* A transferee in a disposition of a U.S. real property interest occurring after December 31, 1984, is required to satisfy its withholding obligation based on the full amount of the sales price regardless of the amount of the payment by the transferee. If the transferor will report gain from the disposition under section 453 of the Code, a withholding certificate that permits the transferee to withhold at a reduced rate may be obtained under the rules of this section. No refund of the amount withheld will be made unless such a withholding certificate is obtained.

.02 With respect to installment sales subject to withholding under section 1445(a), the Service will entertain requests for withholding certificates based on the transferee's agreement to do the following:

1 Withhold and pay over 10 percent, or such lesser amount as determined by the Director, Foreign Operations District, of any down payment, including any liabilities of the transferor assumed by the transferee or liabilities to which the subject U.S. real property interest was subject immediately before and after the transfer;

2 Withhold 10 percent, or such lesser amount as may be determined by the Director, Foreign Operations District, of each subsequent payment, (this amount is in addition to any other amount required to be withheld under section 1441 or 1442);

3 Pay over all amounts withheld using Forms 8288 and 8288-A, including thereon the identification number of the transferor; and

4 Notify the Director prior to the disposition or encumbrance of the subject U.S. real property interest, and upon such disposition or encumbrance pay over to the Service the amount remaining to be withheld pursuant to section 1445(a).

SEC. 8. APPLICATION FOR WITHHOLDING CERTIFICATES FOR AMOUNTS REQUIRED TO BE WITHHELD UNDER SECTION 1445(e)

.01 *In general.* Pursuant to the provisions of sections 1.1445-5T(c), (d), and (e) of the temporary regulations, withholding under section 1445(e) may be reduced or eliminated pursuant to a withholding certificate issued by the Service in accordance with the rules of section 1.1445-6T. A withholding certificate may be issued in cases where adjusted withholding is appropriate, where the relevant taxpayers are exempt from U.S. tax, or where an agreement for the payment of tax is entered into with the Service. The term "relevant taxpayer" shall mean any foreign person that will bear substantive income tax liability by reason fo a transaction upon which withholding is required under section 1445(e) of the Code.

.02 *Applications.* An application for a withholding certificate pursuant to section 1.1445-6T of the temporary regulations must follow the format set forth in section 4.04 of this revenue procedure and provide the information described in sections 4.05 through 4.10, with the following adjustments:

1 The application must include a preliminary item stating that it relates to withholding under section 1445(e) and specifying the applicable provisions of that section;

2 Item 2(b) of section 4.04 must state whether the applicant is a relevant taxpayer or a person required to withhold (and in what capacity that person is required to withhold, for example, as trustee);

3 Item 2(c) of section 4.04 must provide the required information with respect to each relevant taxpayer with respect to which adjusted withholding is sought; and

4 Information concerning the basis for the issuance of the certificate must be provided with respect to each relevant taxpayer.

.03 *Installment sales.* With respect to installment sales subject to withholding under section 1445(e), the Service will entertain requests for withholding certificates based on the entity's or the fiduciary's agreement to do the following:

1 Withhold and pay over 10 percent, or such lesser amount as may be determined by the Director, Foreign Operations District, of any down payment received, including any liabilities of the entity assumed by the transferee or liabilities to which the subject U.S. real property interest was subject immediately before and after the transfer;

2 Withhold 10 percent, or such lessor amount as may be determined by the Director, Foreign Operations District, of each subsequent payment received (this amount is in addition to any other amount required to be withheld under section 1441 or 1442);

3 Pay over all amounts withheld using Forms 8288 and 8288-A, including thereon the identification number of the interest holder subject to withholding; and

4 Notify the Director, Foreign Operations District, prior to the disposition or encumbrance of the subject installment obligation, and upon such disposition or encumbrance pay over to the Service the amount remaining to be withheld under section 1445(e).

SEC. 9 BLANKET WITHHOLDING CERTIFICATE

.01 *In general.* The Director, Foreign Operations District, may issue a withholding certificate (blanket withholding certificate) that excuses withholding with respect to multiple dispositions of U.S. real property interests by the transferor or the transferor's legal representative during a period of no more than 12 months. A blanket withholding certificate may be issued if the transferor holding the U.S. real property interests provides a letter of credit as specified in paragraph 1 of this subsection .01 and enters into an agreement with the Service that meets the requirements of paragraphs 2 and 3 of this subsection .01.

1 The transferor must provide an irrevocable letter of credit in an amount equal to the greater of (i) $100,000 or (ii) 10 percent of the amount to be realized on the projected dispositions covered by the certificate. The letter of credit must meet the requirements of paragraph 3 of subsection 6.01 of this revenue procedure and otherwise must be acceptable to the Director, Foreign Operations District. In addition, the letter of credit by its terms must be valid until at least the last day of the ninth month following the date (including extensions of time) on which a return will be required to be filed with respect to the tax year in which the 12th month covered by the withholding certificate falls. A letter of credit in the form specified in subsection 6.02(5) in most circumstances will be acceptable to the Service when requesting a blanket withholding certificate.

2 The transferor must provide with the letter of credit described in paragraph 1 of this subsection an executed tax payment and security agreement securing the payment of tax with respect to the projected dispositions covered by the blanket withholding certificate. The agreement must meet the requirements of subsections 5.02 through 5.05 of this revenue procedure, as modified to take account of this subsection 9.01 and otherwise must be acceptable to the Director, Foreign Operations District. In addition, the agreement must contain the terms as to notification of specific dispositions required by paragraph 3 of this subsection 9.01 and must provide that, in the event of a failure by the transferor to provide such notification or either timely to file a return, timely to deposit estimated tax, or timely to pay tax with respect to the gain on one or more of the dispositions covered by the certificate, the Director may draw upon the letter of credit to satisfy the transferor's liability for any tax imposed by section 871(b)(1) or 882(a)(1) of the Code, plus interest and penalties, if any, on any one or more dispositions covered by the certificate.

3 The agreement required by paragraph 2 of this subsection must state that the transferor agrees to notify the Director, Foreign Operations District, at least 30 days prior to any disposition of a U.S. real property interest covered by the blanket withholding certificate. This notice shall include the following information:

(a) The name, legal address, and taxpayer identification number, if any, of the transferor or the name and legal address of a legal representative of the transferor with the power to bind the transferor with respect to the disposition;

(b) The name, legal address, and taxpayer identification number, if any, of the transferee or the name and legal address of a legal representative of the transferee with the power to bind the transferee with respect to the disposition;

(c) A description of the U.S. real property interest to be transferred and the anticipated date of the transfer;

(d) The amount that would otherwise have been required to be withheld on the transfer (10 percent of the amount realized unreduced by the maximum tax calculation or for any other reason);

(e) The cumulative total of amounts that would otherwise have been required to be withheld with respect to dispositions (i) which have already taken place or are scheduled to take place prior to the disposition with respect to which notice is being given and (ii) with respect to which the Director has not sent the notice described in subsection .021 below;

(f) The amount of the original letter of credit provided; and

(g) A copy of the transferor's withholding certificate.

An agreement in the form prescribed by subsection 5.06 of this revenue procedure in most cases will be acceptable to the Service for purposes of paragraphs 2 and 3 of this subsection 9.01, with the following modifications: (i) the form should reflect and describe, as the "subject interests," the projected dispositions to be covered by the blanket withholding certificate to which the agreement will relate, (ii) paragraph 2 of the form should be modified to state that the agreement is entered into in connection with an application for a blanket withholding certificate and will extend to all dispositions covered by the blanket withholding certificate, (iii) the third sentence of paragraph 2 should be revised to read "Security for the payment of such liability is provided by an irrevocable letter of credit in the amount of _____, in accordance with the requirements of subsection 9.01(1) of Rev. Proc. 85-41," (iv) a new paragraph should be added to the form (designated as paragraph 3, with the other paragraphs being renumbered accordingly), containing the terms of paragraph 3 of this subsection 9.01, and (v) paragraph 5 of the form (paragraph 6 as renumbered) should be revised to read:

6 In the event of any failure by the transferor or the transferor's legal representative (i) properly to notify the Director, in accordance with paragraph 3, of a disposition of a U.S. real property interest covered by this agreement and the blanket withholding certificate to which it relates, or (ii) timely to file a return, timely to deposit estimated tax, or timely to pay tax with respect to the gain on one or more dispositions covered by this agreement and such certificate, the Director may draw upon the letter of credit provided as related security under this agreement in full to the extent of the tax imposed by section 871(b)(1) or section 882(a)(1) of the Code on any one or more dispositions covered by this agreement and such certificate, plus interest and additions to tax, if any. This amount shall be in addition to any other civil or criminal penalties that may apply with respect to the applicant's use of the withholding certificate in violation of the terms thereof.

.02 A withholding certificate issued by the Director, Foreign Operations District, under this section will state that no withholding is required with respect to any disposition of a U.S. real property interest by the applicant provided that (1) before the date of the transfer, the Director does not provide to the person that would otherwise be required to withhold notice (discussed in paragraph 1 below) that such withholding is required, and (2) the person who would otherwise be required to withhold timely provides the information and material described in paragraph 2 below and the disposition as consummated does not materially fail to correspond to the information so provided.

1 If one of the following conditions is met, the Director will provide notice to the applicant, and to the person required to withhold, that withholding is required despite the prior issuance of a withholding certificate:

(a) The applicant's letter of credit, in light of prior dispositions, is not sufficient to cover the amount otherwise required to be withheld on the transfer, or

(b) The applicant has otherwise violated the provisions of this section.

2 To be exempt from withholding tax liability, the person that would otherwise be required to withhold must, no less than 15 calendar days before the closing of a transaction, provide a statement to the Director containing the following information and material:

(a) The name, legal address, and taxpayer identification number, if any, of the transferee or the name and legal address of a legal representative of the transferee with the power to bind the transferee with respect to the acquisition;

(b) The name, legal address, and taxpayer identification number, if any, of the transferor or the name and legal address of a legal representative of the transferor with the power to bind the transferor with respect to the acquisition;

(c) A description of the acquired U.S. real property interest and the anticipated date of the acquisition;

(d) The total contract price of the acquired U.S. real property interest; the amount of liabilities, if any, to be assumed by the transferee; and the amount of liabilities, if any, subject to which the property is to be acquired; and

(e) A copy of the transferor's withholding certificate.

.03 The Director, Foreign Operations District, will, upon request, provide the transferor with a copy of a security agreement submitted pursuant to paragraph 9.012 executed by the Director, but such an executed copy is not needed to establish the validity of the blanket withholding certificate for purposes of the subject disposition. So long as no notice is given by the Director under section 9.021 and so long as the transferee timely provides the required information and materials, the withholding certificate remains valid.

.04 In the event of any failure by the transferor or the transferor's legal representative properly to notify the Director, in accordance with section 9.013, of a disposition of a U.S. real property interest, or either timely to file a return, timely to deposit estimated tax, or timely to pay tax with respect to the gain on one or more dispositions covered by the blanket withholding certificate, the letter of credit provided under section 9.011 may be drawn upon in full to the extent of the tax imposed by section 871(b)(1) or section 882(a)(1) of the Code, plus interest and additions to tax, if any, on any one or more dispositions covered by the blanket withholding certificate. This amount shall be in addition to any other civil or criminal penalties that may apply with respect to the applicant's use of the withholding certificate in violation of the terms thereof.

SEC. 10. AUTHORIZED REPRESENTATIVE

In any situation covered by this revenue procedure in which a person acts for or is designated as a legal representative of either a transferor or a transferee, such person must be authorized by either a general or a specific power of attorney on file with the Director, Foreign Operations District. Form 2848 may be used for this purpose.

SEC. 11. INQUIRIES

All inquiries should be addressed to:
Director, Foreign Operations District
Attn: FOD:666
1325 K Street, N.W.
Washington, DC 20225

SEC. 12. EFFECTIVE DATE

This revenue procedure is effective for all applications for withholding certificates submitted after September 3, 1985.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 103A; 6a.103A-2.)

Rev. Proc. 85-42

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide issuers of "mortgage subsidy bonds," as defined in section 103A(b)(1) of the Internal Revenue Code, with a list of the "average area purchase price" safe harbor limitations to assist the issuers in determining whether the bonds will be treated as tax-exempt obligations under section 103(a)(1) or (2).

SEC. 2. BACKGROUND

.01 Section 103(a) of the Code provides that gross income does not include interest on (1) the obligations of a state, a territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia, and (2) qualified scholarship funding bonds.

.02 Section 103A was added to the Code by the Mortgage Subsidy Bond Tax Act of 1980, Pub. L. 96-499, 1980-2 C.B. 512. Section 103A was amended by Pub. L. 96-595, 1980-2 C.B. 647, the Tax Equity and Fiscal responsibility Act of 1982, Pub. L. 97-248, 1982-2 C.B. 462, 497, and the Tax Reform Act of 1984, Pub. L. No. 98-369, 1984-3 (Vol. 1) C.B. 1, 409. Section 103A(a) provides that, with certain exceptions, any mortgage subsidy bond will be treated as an obligation not described in section 103(a)(1) or (2). A mortgage subsidy bond is an obligation that is issued as part of an issue a significant portion of the proceeds of which is to be used directly or indirectly to provide mortgages on owner-occupied residences.

.03 Section 103A(b)(2)(A) of the Code provides that any "qualified mortgage bond" will not be treated as a mortgage subsidy bond. A qualified mortgage bond is an obligation issued as part of a "qualified mortgage issue." An issue by a state or political subdivision of a state of one or more obligations is a qualified mortgage issue if (1) all proceeds of the issue (exclusive of issuance costs and a reasonably required reserve fund) are to be used to finance owner-occupied residences, and (2) the issue meets the requirements of subsections (d), (e), (f), (g), (h), (i), and (j) of section 103A.

.04 An issue of obligations issued after September 3, 1982, meets the requirements of subsection (f) of section 103A of the Code if the acquisition cost of each residence, other than a targeted area residence, to be financed with the proceeds of such issue does not exceed 110 percent of the average area purchase price applicable to such residence. In the case of a targeted area residence (defined in subsection (k)), the acquisition cost may not exceed 120 percent of the average area purchase price applicable to such residence. The average area purchase price is, with respect to any residence, the average purchase price of single-family residences in the statistical area in which sufficient statistical information

for the most recent 12-month period is available. Separate determinations are made for new and existing residences, and for two-, three-, and four-family residences.

.05 Section 103A(f)(2) of the Code provides that the determination of whether the acquisition cost of each residence does not exceed 110 or 120 percent of the average area purchase price for that statistical area shall be made as of the date on which the commitment to provide the financing is made or, if earlier, the date of the purchase of the residence.

.06 Temporary Income Tax Regulations relating to the tax-exempt status of certain mortgage subsidy bonds under section 103A of the Code were published in the Federal Register dated July 1, 1981 (46 FR 34311), T.D. 7780, 1981-2 C.B. 25, and were amended November 10, 1981 (46 FR 55513), T.D. 7794, 1981-2 C.B. 40; May 24, 1982 (47 FR 22360), T.D. 7817, 1982-1 C.B. 23; June 8, 1982 (47 FR 24701), T.D. 7819, 1982-2 C.B. 51; June 29, 1982 (47 FR 28094), T.D. 7821, 1982-2 C.B. 52, and December 12, 1984 (49 FR 48292), T.D. 7995, 1985-1 C.B. 49. The temporary regulations under section 6a.103A-2(f)(5)(i) provide that an issuer may rely upon the average area purchase price safe harbor limitations published by the Department of the Treasury for the statistical area in which a residence is located. An issuer may use a limitation different than the published safe harbor limitation if the issuer has more accurate and comprehensive data. However, when computing the average area purchase price for a statistical area that is a county, the issuer ordinarily must make the computation on an individual county basis and may not combine two or more counties.

.07 Section 103A(1)(4)(A) of the Code provides that a "statistical area" means (i) a standard metropolitan statistical area (SMSA) and (ii) any county that is not within an SMSA. In Press Release OMB-83-20, dated June 27, 1983, the Office of Management and Budget revised definitions of the nation's SMSAs effective June 30, 1983. The term "SMSA" was shortened to "metropolitan statistical area" (MSA). An area qualifies as an MSA if it contains a city of at least 50,000 population, or an urbanized area of at least 50,000 with a total metropolitan population of at least 100,000. If an area has more than one million population and meets certain other specified requirements, it is termed a "consolidated metropolitan statistical area" (CMSA), consisting of major components recognized as "primary metropolitan statistical areas" (PMSA).

.08 The average area purchase price safe harbor limitations for the period beginning August 2, 1984, and ending August 1, 1985, were released by News Release IR-84-86 on August 2, 1984, and were published in Rev. Proc. 84-56, 1984-2 C.B. 491.

SEC. 3. APPLICATION

.01 Issuers of qualified mortgage bonds may rely on the average area purchase price safe harbor limitations contained in this revenue procedure for the period beginning August 2, 1985, and ending August 1, 1986. The safe harbor limitations are estimates of the average area purchase price on which issuers may rely to satisfy the requirements of section 103A(f) of the Code. The estimates are based on information from the Federal Home Loan Bank Board's monthly survey of "Terms of Conventional Home Mortgages." The survey contains sales price estimates for both new and existing one-family nonfarm residences. The safe harbor limitations are based on the sales price estimates for the calendar year 1984. The sales price data are adjusted for nonconventional (Federal Housing Administration (FHA) insured and Veterans Administration guaranteed) home sales. The data are presented for each MSA or PMSA for which a sufficient data sample was available. Data for the remaining areas in each state were combined to produce an estimate for "all other areas" in the state. If the data sample for a state or for "all other areas" in a state was too small, a regional estimate of the average purchase price was used. Safe harbor limitations for two-family residences are equal to the appropriate average area purchase price for single-family residences multiplied by the following adjustment factor: 1.126 for two-family residences, 1.363 for three-family residences, and 1.585 for four-family residences. These adjustment factors are similar to those used for the FHA mortgage limitations.

.02 Issuers of qualified mortgage bonds that sell the obligations prior to September 1, 1985, and make commitments prior to October 31, 1985, to provide financing for owner-occupied residences may continue to rely on the average area purchase price safe harbor limitations contained in Rev. Proc. 84-56. Issuers of qualified mortgage bonds that have received a letter ruling from the Service approving an average area purchase price limitation that is higher than the safe harbor limitation in this revenue procedure may rely on the letter ruling for 1 year after the date of the letter ruling.

.03 If an MSA or PMSA is contained in two or more states, the acquisition cost of a residence within that MSA or PMSA shall not exceed the safe harbor limitation provided for the MSA or PMSA, not the limitation provided for all other areas in the state.

.04 The following average area purchase price safe harbor limitations have not been adjusted to reflect either the 110 percent of the average area purchase price described in section 103A(f)(1) of the Code or the 120 percent of the average area purchase price described in section 103A(f)(5).

State and Area Designation	Average Area Purchase Price Safe Harbor Limitations for Single-Family Residences	
	New	Existing
Alabama		
Birmingham MSA	$ 96,600	$ 70,500
Mobile MSA	71,000	74,300
All Other Areas	71,600	67,400
Alaska		
Anchorage MSA	127,900	142,900
All Other Areas	141,600	128,800
Arizona		
Phoenix MSA	104,500	104,300
Tucson MSA	117,600	99,900
All Other Areas	85,500	71,800
Arkansas		
All Areas	71,500	59,000
California		
Anaheim-Santa Ana PMSA	161,900	151,400
Bakersfield MSA	128,000	84,900
Fresno MSA	106,800	101,700
Los Angeles-Long Beach PMSA	134,800	136,200
Oakland PMSA	142,800	149,900
Oxnard-Ventura PMSA	141,800	132,900
Riverside-San Bernardino PMSA	117,100	107,900
Sacramento MSA	112,500	108,000
Salinas-Seaside-Monterey MSA	131,800	137,900
San Diego MSA	129,000	126,500
San Francisco PMSA	142,800	149,900
San Jose PMSA	153,000	159,400
Stockton MSA	105,400	85,700
Vallejo-Fairfield-Napa PSMA	113,600	110,000
All Other Areas	105,400	112,200
Colorado		
Boulder-Longmont PMSA	124,600	118,100
Denver PMSA	124,600	118,100
All Other Areas	106,000	81,000
Connecticut		
Bridgeport-Milford MSA	94,800	115,200
Danbury MSA	108,300	100,500
Hartford PMSA	93,800	102,600
New Haven-Meriden MSA	89,500	85,100
Norwalk PMSA	159,200	147,500
Stamford PMSA	172,500	195,200
Waterbury MSA	93,300	83,400
All Other Areas	118,400	110,700
Delaware		
Wilmington (DE-NJ-MD) PMSA	99,400	57,400
All Other Areas	84,100	60,900
District of Columbia		
Washington (DC-VA-MD) MSA	140,900	130,800
Florida		
Daytona Beach MSA	$ 75,000	$ 67,100
Ft. Lauderdale-Hollywood-Pompano Beach PSMA	77,500	82,100
Ft. Myers MSA	73,400	91,300
Jacksonville MSA	78,600	91,200
Miami-Hialeah PMSA	84,000	97,200
Orlando MSA	85,700	83,300
Pensacola MSA	76,500	81,700
Sarasota MSA	95,500	81,200

State and Area Designation	Average Area Purchase Price Safe Harbor Limitations for Single-Family Residences	
	New	Existing
Tallahassee MSA	57,300	70,300
Tampa-St. Petersburg-Clearwater MSA	89,400	73,900
West Palm Beach-Boca Raton-Delray Beach MSA	101,600	94,600
All Other Areas	73,900	69,700
Georgia		
Atlanta MSA	103,400	97,500
Augusta (GA-SC) MSA	76,900	66,000
All Other Areas	70,000	58,500
Hawaii		
All Areas	158,900	120,900
Idaho		
All Areas	84,200	70,700
Illinois		
Aurora-Elgin PMSA	109,600	91,900
Chicago PMSA	109,600	91,900
Joliet PMSA	109,600	91,900
Lake County PMSA	109,600	91,900
All Other Areas	70,200	51,600
Indiana		
Indianapolis MSA	94,200	65,600
All Other Areas	70,100	48,700
Iowa		
All Areas	74,200	57,800
Kansas		
Topeka MSA	76,900	62,700
Wichita MSA	91,400	72,400
All Other Areas	75,900	57,500
Kentucky		
Louisville (KY-IN) MSA	87,300	59,500
All Other Areas	73,800	62,400
Louisiana		
Baton Rouge MSA	77,700	77,500
New Orleans MSA	90,000	81,800
All Other Areas	73,500	78,800
Maine		
All Areas	70,000	62,700
Maryland		
Baltimore MSA	107,500	77,800
All Other Areas	87,800	66,200
Massachusetts		
Boston PMSA	$101,500	$113,600
All Other Areas	100,600	86,100
Michigan		
Detroit PMSA	92,400	73,100
All Other Areas	72,600	57,300
Minnesota		
Minneapolis-St. Paul (MN-WI) MSA	105,700	106,900
All Other Areas	77,000	61,200
Mississippi		
All Areas	85,800	64,500
Missouri		
Kansas City Missouri-Kansas MSA	107,300	75,300
St. Louis (MO-IL) PMSA	92,400	71,400
All Other Areas	72,700	52,600
Montana		
All Areas	104,600	88,800

State and Area Designation	Average Area Purchase Price Safe Harbor Limitations for Single-Family Residences	
	New	Existing
Nebraska		
Omaha (NE-IA) MSA	84,900	80,100
All Other Areas	75,900	57,500
Nevada		
Reno MSA	91,600	103,600
All Other Areas	79,300	100,500
New Hampshire		
All Areas	99,300	80,300
New Jersey		
Middlesex-Somerset-Hunterdon PMSA	93,900	97,000
Monmouth-Ocean PMSA	119,600	105,500
Newark PMSA	151,900	130,000
All Other Areas	84,400	94,500
New Mexico		
Albuquerque MSA	84,300	92,000
All Other Areas	76,900	59,700
New York		
Buffalo PMSA	85,200	55,500
Nassau-Suffolk PMSA	131,800	126,300
New York PMSA	129,400	137,200
Orange County PMSA	81,500	73,700
Rochester MSA	93,700	73,300
Syracuse MSA	84,600	57,900
All Other Areas	77,000	52,100
North Carolina		
Charlotte-Gastonia-Rock Hill (NC-SC) MSA	83,300	83,500
Greensboro-Winston Salem-High Point MSA	77,000	68,600
Raleigh-Durham MSA	88,400	82,400
All Other Areas	72,600	61,400
North Dakota		
All Areas	$ 57,600	$ 66,900
Ohio		
Akron PMSA	74,100	70,900
Cincinnati (OH-KY-IN) PMSA	112,400	80,900
Cleveland PMSA	87,400	75,600
Columbus MSA	72,500	72,000
All Other Areas	72,200	54,700
Oklahoma		
Oklahoma City MSA	105,800	78,900
All Other Areas	73,200	68,500
Oregon		
Portland PMSA	93,900	87,600
All Other Areas	72,000	69,700
Pennsylvania		
Allentown-Bethlehem (PA-NJ) MSA	88,200	64,200
Beaver County PMSA	101,500	66,000
Harrisburg-Lebanon-Carlisle MSA	76,700	65,200
Philadelphia (PA-NJ) PMSA	99,000	71,600
Pittsburgh PMSA	101,500	66,000
Reading MSA	68,000	58,000
Scranton-Wilkes-Barre MSA	79,000	51,800
York MSA	62,100	57,200
All Other Areas	64,100	51,000
Rhode Island		
Pawtucket-Woonsocket-Attleboro (RI-MA) PMSA	78,300	70,100
Providence PMSA	78,300	70,100

State and Area Designation	Average Area Purchase Price Safe Harbor Limitations for Single-Family Residences	
	New	Existing
All Other Areas	94,000	85,800
South Carolina		
Charleston MSA	100,300	89,600
Greenville-Spartanburg MSA	83,200	56,400
All Other Areas	84,200	71,500
South Dakota		
All Areas	104,600	88,800
Tennessee		
Memphis (TN-AR-MS) MSA	81,800	90,400
Nashville MSA	86,300	80,100
All Other Areas	67,000	61,700
Texas		
Austin MSA	135,200	98,900
Brazoria PMSA	103,900	96,100
Dallas PMSA	126,800	101,700
Fort Worth-Arlington PMSA	126,800	101,700
Houston PMSA	103,900	96,100
San Antonio MSA	110,600	99,900
All Other Areas	77,500	70,600
Utah		
Salt Lake City-Ogden MSA	95,200	95,500
All Other Areas	83,400	69,700
Vermont		
All Areas	80,300	70,100
Virginia		
Norfolk-Virginia Beach-Newport News MSA	89,000	93,600
Richmond-Petersburg MSA	83,300	91,000
All Other Areas	74,900	67,000
Washington		
Seattle PMSA	98,700	103,300
Tacoma PMSA	93,500	98,300
Vancouver PMSA	93,900	87,600
All Other Areas	86,800	70,600
West Virgnia		
All Areas	98,500	74,300
Wisconsin		
Milwaukee PMSA	103,900	80,700
All Other Areas	77,300	59,400
Wyoming		
All Areas	104,600	88,800

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 401, 403, 408, 410, 411, 414, 415, 416; 1.401-1, 1.403(a)-1, 1.408-1, 1.410(a)-1, 85-43, 1.411(a)-1, 1.415-1, 1.416-1.)

Rev. Proc. 85-43

SECTION 1. PURPOSE

.01 This revenue procedure supersedes the procedures set forth in Rev. Proc. 81-12, 1981-1 C.B. 652, in light of sections 414(m)(5) and 414(n), added to the Internal Revenue Code by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. 97-248, 1982-2 C.B. 462.

.02 This revenue procedure prescribes the procedures relating to the qualification, under section 401(a) or 403(a) of the Code, of an employees' pension, profit-sharing, stock bonus, or annuity plan established or maintained by (1) an employer that is, or may be, a member of an affiliated service group within the meaning of section 414(m) of the Code, or (2) an employer that utilizes the services of leased employees within the meaning of section 414(n) of the Code.

.03 Under this revenue procedure the National Office of the Internal Revenue Service will not issue rulings on whether particular entities are members of an affiliated service group within the meaning of section 414(m) of the Code, unless the ruling request was submitted before the effective date of this revenue procedure.

SEC. 2 BACKGROUND

.01 *Applicable Law Prior To TEFRA.* Section 414(m) of the Code as originally added by the Miscellaneous Revenue Act of 1980, Pub. L. 96-605, 1980-2 C.B. 702, provides that for purposes of certain employee benefit requirements including sections 401(a), 408(k), 410, 411, and 415 of the Code, employees of an affiliated service group, as defined in section 414(m), shall be treated as employed by a single employer. Thus, for example, if an employer that is a member of an affiliated service group establishes or maintains an employees' pension, annuity, profit-sharing, or stock bonus plan, employees of other members of the affiliated service group must be considered employees of that member in determining whether its plan meets applicable qualification requirements of section 401(a).

.02 *TEFRA and Other Statutory Changes.* Section 414(m)(5) of the Code, as added by section 246 of TEFRA, provides that certain organizations performing management functions and the organizations for which the management functions are performed will constitute an affiliated service group even though those organizations would not have been an affiliated service group for preTEFRA years. Section 240 of TEFRA, which added section 416 of the Code relating to top-heavy plans, amended section 414(m) to provide that employees of an affiliated service group shall also be treated as employed by a single employer for purposes of section 416. Section 414(n) of the Code, as added by section 248 of TEFRA, provides that for purposes of certain employee benefit requirements under sections 401(a), 408(k), 410, 411, 415, 416, a person who is employed by an organization ("leasing organization") and performs services for another trade or business ("recipient") shall be treated as an employee of the recipient when certain requirements are met. Section 526 of the Tax Reform Act of 1984 (TRA), Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1, 382, amended section 414(m)(6)(B) of the Code so that the attribution rules for ownership under section 318(a) of the Code, instead of section 267(c), are used for determining whether a group of employers constitutes an affiliated service group.

.03 *Impact of Statutory Requirements.*

1 Section 414(m) of the Code does not impact on any plan unless the employer maintaining the plan is a member of an affiliated service group. In the case of an employer that is a member of an affiliated service group, section 414(m) affects several important areas of plan qualification. For example, being a member of an affilitaed service group expands the group of employees who must be considered in applying the coverage requirements of section 410(b). Also, certain form requirements are changed. This includes plan language for crediting years of service with respect to members of the affilitaed service group for purposes of the minimum participation standards in section 410(a) and the minimum vesting standards in section 411. For further discussion of these requirements, see Rev. Rul. 81-105, 1981-1 C.B. 256.

2 Section 414(n) of the Code does not impact on any plan if the employer maintaining the plan directly employs all of its employees. However, any employer ("recipient") that utilizes the services of "leased employees" may be required to consider the leased employees in determining whether its plan continues to satisfy certain qualification requirements. For example, the leased employees may be required to be considered in applying the coverage requirements of section 410(b), and, once covered, the entire period for which a leased employee has performed services for the recipient must be taken into account in determining years of service for purposes of both participation and vesting under the recipient's plan.

.04 *Applicable Procedures.*

1 Rev. Proc. 83-36, 1983-1 C.B. 763, sets forth for the general procedures of the Internal Revenue Service for issuing National Office rulings and opinion letters in the employee plans and exempt organizations area, and for issuance of determination letters by employee plans key district offices.

2 Notice 83-12, 1983-2 C.B. 412, provides procedures pertaining to the issuance of determination letters by employee plans key district offices on the qualification of pension, profit-sharing, and stock bonus plans that contain provisions to comply with the changes made by TEFRA.

3 Rev. Proc. 81-12, 1981-1 C.B. 652, provides procedures for obtaining rulings from the National Office regarding whether particular entities are members of an affiliated service group and procedures for obtaining termination letters from employee plans key district offices regarding the qualification of plans established or maintained by a member of an affiliated service group.

4 Rev. Proc. 80-30, 1980-1 C.B. 685, sets forth the general procedures pertaining to issuance of determination letters by employee plans key district offices on the qualification of pension, annuity, profit-sharing, and stock bonus plans involving sections 401, 403(a), 409A, and 4975(e) of the Code.

.05 *Effective Dates of Section 414(m) and 414(n).* Section 414(m)(1), (2), (3), (4), and (6) is effective immediately for all plans established after November 30, 1980. For plans in existence on November 30, 1980, section 414(m)(1), (2), (3), (4), and (6) is effective for plan years beginning after November 30, 1980. Section 414(m)(5) and section 414(n) are effective for taxable years beginning after December 31, 1983. Section 414(m)(6)(B), as amended by section 526 of TRA, is effective for taxable years beginning after December 31, 1984.

SEC. 3. RESPONSIBILITIES OF EMPLOYERS AND PLAN ADMINISTRATORS

.01 *In General.* An employer is responsible for determining at any particular time whether it is a member of an affiliated service group, and, if so, whether its plan(s) continues to meet the requirements of section 401(a) of the Code after the effective date of section 414(m), including section 414(m)(5). An employer or plan administrator also is responsible for taking appropriate action relative to their qualified plan if that employer becomes, or ceases to be, a member of an affiliated service group. An employer that is the recipient of services of leased employees within the meaning of section 414(n) of the Code also is responsible for determining at any particular time whether a leased employee is deemed an employee of the recipient for qualified plan purposes.

.02 *Employers Not Affected by Section 414(m) or 414(n).* An employer that is not and has not been a member of an affiliated service group, or an employer that does not and has not utilized the services of leased employees, is not required to change its qualified plan or plans to satisfy section 414(m) or 414(n) of the Code.

.03 *Determination Letter Program.* An employer that is subject to the provisions of section 414(m) or 414(n) of the Code may want a determination as to the effect of such provisions on the qualified status of its plan. For example, questions may arise whether certain form requirements are satisfied or coverage is adequate under section 410(b). Section 4 of this revenue procedure provides that Service key district offices will issue determination letters which consider the impact of section 414(m) or 414(n) on the qualified status of the plan. This determination letter procedure will be available (1) in the case of an initial request for a determination letter, (2) for a determination letter request on a plan amendment, and (3) in certain circumstances, even though the plan has not been amended.

SEC. 4 DETERMINATION LETTERS

.01 *Procedures For Obtaining Determination Letters.* An employer that has adopted a new employee plan, or an employer that has amended an employee plan to satisfy section 414(m) or 414(n) of the Code, may apply for a determination letter, under Rev. Proc. 80-30 and this revenue procedure, as to the plan's qualification, taking into consideration employees of any other organization that must be treated as employees of the applicant. Also, if an employer believes that the current plan, without amendment, will satisfy the requirements of section 401(a), but the employer's affiliated service group status has changed, the plan may be submitted for a determination letter which will consider the change in status and its effect on the plan. Generally, a determination letter will cover section 414(m) or 414(n) only if the employer submits, with the appropriate determination letter application, the information specified under section 5.

.02 *Omission of Material Facts.* Failure to properly indicate that there is or may be an affiliated service group and to provide the information specified in section 5.01 of this procedure, or failure to properly indicate that an employer is utilizing the services of leased employees and to provide the information specified in section 5.02 of this procedure, is an omission of a material fact. Such an omission will result in the applicant being unable to rely on any favorable determination letter concerning the effect of section 414(m) or 414(n) of the Code on the qualified status of the plan.

.03 *Statement in Determination Letters.* If the Service considers whether the plan of an employer satisfies the requirements of section 414(m) or 414(n) of the Code, the determination letter issued to the employer will state that questions arising under section 414(m) or 414(n) have been considered, and that the plan satisfies qualification requirements relating to that section. Absent such a statement pertaining to section 414(m) or 414(n), a determination letter does not apply to any qualification issue arising by reason of those provisions of the Code.

.04 *Master and Prototype Plan Adopters-Determination Letters.* An employer that has adopted a master or prototype plan (including an employer that has adopted a standardized plan) that wants a determination as to the effect of section 414(m) or 414(n) of the Code on the qualified status of its plan must attach the information required by section 5 of this revenue procedure to Form 5307 (Short Form Application For Determination For Employee Benefit Plan) and submit the information, Form 5307, Form 5302 (Employee Census), and any other materials necessary to make a determination to the appropriate key district office.

.05 *Reliance on Determination Letters.* The failure of the adopting employer to follow the above procedures will result in the employer being unable to rely on any favorable determination letter concerning the effect of section 414(m) or 414(n) of the Code on the qualified status of the plan.

SEC. 5. REQUIRED INFORMATION

.01 *Information to Be Submitted with Applications for Determination Letters Covering Section 414(m) of the Code.* A determination letter issued with respect to a plan's qualification under section 401(a) or 403(a) of the Code will be a determination as to the effect of section 414(m) upon that plan's qualified status only if the application includes:

1 A description of the nature of the business of the employer, specifically discussing whether it is a service organization or an organization whose principal business is the performance of management functions for another organization, including the reasons therefor;

2 The identification of other members (or possible members) of the affiliated service group;

3 A description of the nature of the business of each member (or possible member) of the affiliated service group describing the type of organization (corporation, partnership, etc.) and indicating whether such member is a service organization or an organization whose principal business is the performance of management functions for the other group member(s);

4 The ownership interests between the employer and the members (or possible members) of the affiliated service group (including ownership interests as described in section 414(m)(2)(B)(ii) or 414(m)(6)(B) of the Code);

5 A description of services performed for the employer by the members (or possible members) of the affiliated service group, or vice versa (including the percentage of each member's or possible member's gross receipts and service receipts provided by such services, if available, and data as to whether the services are a significant portion of the member's business) and whether, as of December 13, 1980, it was not unusual for the services to be performed by employees of organizations in that service field in the United States;

6 A description of how the employer and the members (or possible members) of the affiliated service group associate in performing services for other parties;

7 A description of management functions, if any, performed by the employer for the member(s) (or possible member(s)) of the affiliated service group, or received by the employer from any other member(s) (or possible member(s)) of the group (including data as to whether such management functions are performed on a regular

and continuing basis) and whether it is not unusual for such management functions to be performed by employees of organizations in the employer's business field in the United States;

8 If management functions are performed by the employer for the member(s) (or possible member(s)) of the affiliated service group, a description as to what part of the employer's business constitutes the performance of management functions for the member(s) (or possible member(s)) of the group (including the percentage of gross receipts derived from management activities as compared to the gross receipts from other activities);

9 A brief description of any other plan(s) maintained by the members (or possible members) of the affiliated service group, if such other plan(s) is designated as a unit for qualification purposes with the plan for which a determination letter has been requested;

10 A description of how the plan(s) satisfies the coverage requirements of section 410(b) if the members (or possible members) of the affiliated service group are considered part of an affiliated service group with the employer;

11 A copy of any ruling issued by the National Office on whether the employer is a member of an affiliated service group; a copy of any prior determination letter that considered the effect of section 414(m) on the qualified status of the employer's plan; and, if known, a copy of any such ruling or determination letter issued to any other member (or possible member) of the same affiliated service group, accompanied by a statement as to whether the facts upon which the ruling or determination letter was based have changed.

.02 *Information to Be Submitted with Applications for Determination Letters Covering Section 414(n) of the Code.* Unless the plan provides that all leased employees within the meaning of section 414(n)(2) of the Code are treated as common law employees for all purposes under the plan, a determination letter issued with respect to the plan's qualification under section 401(a) or 403(a) of the Code will be a determination as to the effect of section 414(n) upon the plan's qualified status only if the application includes:

1 A description of the nature of the business of the recipient organization;

2 A copy of the relevant leasing agreement (s);

3 A description of the function of all leased employees within the trade or business of the recipient organization (including data as to whether all leased employees are performing services on a substantially full-time basis) and whether it is not unusual for the services to be performed by employees of organizations in the recipient organization's business field in the United States;

4 If the recipient organization is relying on any qualified plan(s) maintained by the employee leasing organization for purposes of qualification of the recipient organization's plan, a description of such plan(s) (including a description of the contributions or benefits provided for all leased employees which are attributable to services performed for the recipient organization, plan eligibility, and vesting).

SEC. 6. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 83-36 and Rev. Proc. 80-30 are amplified to prescribe the additional procedures for obtaining a determination letter which considers issues arising under section 414(m) or 414(n) of the Code.

.02 Notice 83-12 is amplified to provide additional information that must be submitted in a determination letter request when the applicant is a member of a management-type affiliated service group or the applicant utilizes the services of an employee(s) of an employee leasing organization.

.03 Rev. Proc. 81-12 is superseded.

SEC. 7. EFFECTIVE DATE

This revenue procedure is effective August 19, 1985. As of the effective date of this revenue procedure employers may no longer request a ruling from the National Office as to whether or not they are members of an affiliated service group.

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26 CFR 601.202: Closing agreements.
(Also Part I, Sections 108, 1017, 7121; 1.108(a)-1, 1.1017-2, 301.7121-1.)

Rev. Proc. 85-44

SECTION 1. PURPOSE

Rev. Proc. 78-16, 1978-2 C.B. 489, sets forth the procedure to be followed by a taxpayer who has requested an advance ruling seeking a variation from the general rule of section 1.1017-1 of the Income Tax Regulations, relating to the adjustment to basis of depreciable property resulting from a discharge of indebtedness, and who desires to enter into a closing agreement pursuant to section 1.1017-2(b) because the taxpayer has a substantial number of depreciable properties. The purpose of this revenue procedure is to modify and update Rev. Proc. 78-16 in light of amendments to sections 108 and 1017 of the Internal Revenue Code by the Bankruptcy Tax Act of 1980 (P.L. 96-589), 1980-2 C.B. 607, and the addition of section 168 to the Code by the Economic Recovery Tax Act of 1981 (P.L. 97-34), 1981-2 C.B. 256.

SEC. 2. BACKGROUND

Section 108(a)(1)(C) of the Code provides that gross income does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if the indebtedness discharged is qualified business indebtedness. In addition, section 108(d)(4) provides that the indebtedness of the taxpayer shall be treated as qualified business indebtedness if (and only if) the indebtedness was incurred or assumed by a corporation, or an individual in connection with property used in his trade or business and such taxpayer makes an election with respect to such indebtedness. Section 1017(b)(3)(A), read in conjunction with section 1017(a), provides that when qualified business indebtedness is discharged the basis adjustment is only to be applied to reduce the basis of any depreciable property held by the taxpayer at the beginning of the taxable year following the year in which the discharge occurred. Section 1017(b)(3)(B) provides that, for purposes of section 1017, the term "depreciable property" means any property of a character subject to the allowance for depreciation, but only if a basis reduction under section 1017(a) will reduce the amount of depreciation or amortization that would otherwise be allowable for the period immediately following the reduction. This would include prop-

erty subject to cost recovery under section 168. Section 1.1017-1 of the regulations provides, in general, that adjustments will, except as otherwise provided in section 1.1017-2, be made to the cost or other basis of property in a specified manner and order. Section 1.1017-2 provides for a variation from the general rule that may involve adjusting the basis of only part of the taxpayer's property, or adjusting the basis of all of the taxpayer's property, according to a fixed allocation. Agreement between the taxpayer and the Commissioner of Internal Revenue as to any variations from the general rule shall be effected only by a closing agreement entered into under the provisions of section 7121.

Taxpayers who own a substantial number of depreciable properties have elected under section 108 of the Code to exclude from gross income the discharge of qualified business indebtedness and have requested, as prescribed in section 1.1017-2 of the regulations, a variation that will allow the taxpayers to reduce the basis of only some of their depreciable properties (the "selected assets").

SEC. 3. APPLICATION

The Service will not issue an advance ruling or enter into a closing agreement when it appears the taxpayer will gain a significant tax advantage by adjusting the basis of only selected assets. However, the Service will generally issue an advance ruling and enter into a closing agreement permitting a variation from the general rule if the following conditions are met.

.01 The taxpayer has filed or intends to file an election under section 108(d)(4) of the Code with its return for the taxable year in which the discharge of indebtedness occurred.

.02 The discharge of indebtedness did not occur in a case under title 11 of the United States Code (relating to bankruptcy) nor when the taxpayer was insolvent.

.03 The discharged indebtedness would not be treated as price reduction under section 108(e)(5) of the Code.

.04 The taxpayer did not select the assets for basis adjustment with any preconceived plan or intention to dispose of those assets.

.05 The selected assets are depreciable properties having a weighted average remaining "useful life" no longer than the weighted average remaining "useful life" of all the taxpayer's depreciable properties, including properties subject to amortization or cost recovery, but excluding fully depreciated or amortized properties owned by the taxpayer at the beginning of the taxable year following the taxable year in which the discharge of indebtedness occurred. For purposes of this representation only, the "useful life" for properties subject to cost recovery under section 168 of the Code shall be the recovery period used by the taxpayer.

.06 The taxpayer has sufficient bases in the selected assets to absorb the basis adjustments required by section 1017 of the Code at the beginning of the taxable year following the taxable year in which the discharge of indebtedness occurred.

.07 None of the selected assets that are depreciated under section 167 of the Code will have their bases reduced below salvage value.

.08 The selected assets are not depreciated under the retirement—replacement—betterment method of accounting.

.09 To ensure that ordinary income treatment eventually will be given to the full amount of basis reduction, the taxpayer agrees that when a selected asset is sold, exchanged, retired, or otherwise disposed of, an amount equal to the income excluded and attributed to that asset under the section 108 election shall be included in gross income as ordinary income and added back to the basis of the selected asset at the time of its disposition.

.10 Only that portion of the basis of a selected asset remaining after applying the appropriate amount of adjustment resulting from the section 108 election shall be subject to the allowable deduction under section 167 or 168 of the Code, whichever is applicable, in the years subsequent to the year in which the discharge of indebtedness occurred.

SEC. 4. IMPLEMENTATION

A taxpayer wishing to take advantage of this procedure should file a request for a ruling under Rev. Proc. 85-44, and request that a closing agreement be entered into with the Commissioner of Internal Revenue as provided in section 1.1017-2 of the regulations. The request for ruling and closing agreement should be addressed to the Commissioner of Internal Revenue, Attention: CC:C, 1111 Constitution Avenue, N.W., Washington D.C. 20224, and should request the application of Rev. Proc. 85-44. If such requests are approved the taxpayer must attach a copy of the ruling and closing agreement to its return for the taxable year in which the discharge of indebtedness occurred.

SEC. 5. INQUIRIES

Inquiries regarding this Revenue Procedure should be addressed to the Commissioner of Internal Revenue, Attention: CC:C, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

SEC. 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 78-16 is modified and superseded.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, Section 994; 1.994-1.)

Rev. Proc. 85-45

SECTION 1. PURPOSE AND SCOPE

The purpose of this revenue procedure is to modify and supersede Rev. Proc. 84-3, 1984-1 C.B. 361, in order to conform it to section 1.994-1(e)(5)(v) of the Income Tax Regulations.

Rev. Proc. 84-3 prescribes the conditions and the procedures to be followed in cases in which intercompany prices paid by a domestic internatonal sales corporation (DISC) to its related supplier or commissions paid by a related supplier to a DISC, as originally determined by the parties under section 994 of the Internal Revenue Code, are redetermined by the Internal Revenue Service in a manner that results in an increase of the intercompany prices or reduction of the commissions. Procedures are prescribed below by which the DISC's related supplier and/or shareholder may request an adjustment of accounts and a reclassification of actual distributions previously made with

respect to all or a part of the amount of the pricing or commission redetermination.

SEC. 2. BACKGROUND

Section 995(b) of the Code treats a portion of a DISC's taxable income for each taxable year as a deemed distribution to its shareholder, which is taxable to the shareholder as a dividend. Under section 996(a)(3), actual distributions by a DISC out of previously taxed income (PTI), which consists of amounts taxed to a DISC's shareholder under section 995(b), are excluded from the shareholder's gross income. Actual distribution by a DISC out of its accumulated DISC income (ADI) or other earnings and profits (not constituting either PTI or ADI) are taxable to the DISC's shareholder as ordinary dividends.

Redeterminations by the Service of intercompany prices or commissions determined under the section 994(a) pricing rules generally have the effect of reducing a DISC's PTI and ADI for the taxable year of the redetermination. As a result of such a reduction in PTI, a portion of any nontaxable distribution previously made by a DISC out of PTI as originally computed by the parties is reclassified as a taxable distribution out of ADI or other earnings and profits.

SEC. 3. CASES IN WHICH ADJUSTMENT OF ACCOUNTS WILL BE PERMITTED

.01 The treatment provided in this revenue procedure will be available with respect to all transactions for any taxable year of a DISC to which intercompany prices paid by the DISC to its related supplier, or commissions paid by the related supplier to the DISC, as originally determined by the parties under section 994 of the Code, are subsequently redetermined by the Service in a manner that results in an increase of the intercompany prices or reduction of the commissions, provided it is determined by the Service that the arrangements or transactions, or the terms thereof, giving rise to the redetermined intercompany prices or commissions did not have as one of their principal purposes the avoidance of Federal income tax. The determination as to whether one of the principal purposes was avoidance of Federal income tax will be based upon all the facts and circumstances of the case.

.02 The treatment provided in this revenue procedure will not be available if any part of any underpayment of tax by the related supplier and/or shareholder for any taxable year affected by the Service's redetermination is due to fraud.

SEC. 4. ADJUSTMENT TO BE MADE OR ALLOWED

.01 In a case qualifying under section 3 above in which the DISC's shareholder complies with the requirements of section 5 below, in lieu of establishing an account receivable in accordance with section 1.994-1(e)(5)(i) of the regulations for all or part of an amount due a related supplier, the related supplier and DISC are permitted to treat all or part of any distribution which was made by the DISC out of its PTI with respect to the year to which the Service's determination or redetermination relates as an additional payment of transfer price or repayment of commission (and not as a distribution) made as of the date the distribution was made. To the extent that a distribution is so treated under section 1.994-1(e)(5)(v), it shall cease to qualify as a distribution for any Federal income tax purpose, and the DISC's PTI account shall be adjusted accordingly.

.02 Any additional amount arising on the determination or redetermination due the related supplier after the treatment under section 4.01 above shall be represented by an account receivable established under section 1.994-1(e)(5)(i) of the regulations. Such account receivable and any interest attributable thereto shall be paid in the time and manner set forth in section 1.994-1(e)(5).

.03 If all or part of any distribution made to a shareholder other than the related supplier is recharacterized under section 1.994-1(e)(5)(v) of the regulations, the related supplier shall establish an account receivable from that shareholder for the amount so recharacterized. Such account receivable and any interest attributable thereto shall be paid in the time and manner set forth in section 1.994-1(e)(5).

.04 The election of a DISC's shareholder to invoke this revenue procedure in no way affects the redetermination by the Service of the intercompany prices payable by the DISC or the commissions payable to the DISC. Such election shall, however, affect the taxable income of the shareholder, the DISC, and the DISC's related supplier to the extent indicated by sections 4.01, 4.02, and 4.03 above.

SEC. 5. PROCEDURES TO BE FOLLOWED

.01 Cases pending with the Internal Revenue Service

1 If a DISC's shareholder desires to invoke this revenue procedure, it must file a request in writing with the District Director of Internal Revenue or the Appeals Office having jurisdiction of the case before closing action is taken on the redetermination of DISC taxable income. The request shall be signed by a person having the authority to sign the shareholder's Federal income tax returns, and shall contain the following:

(a) a request that the shareholder be granted the treatment provided by section 4 of this revenue procedure for the years indicated; and

(b) an offer to enter into a closing agreement under section 7121 of the Code as provided in section 5.013 below.

2 The Service will determine whether the affected parties qualify under section 3 above for the requested treatment and inform the shareholder of its decision. If the request is rejected, the shareholder may pursue the matter through established channels of administrative appeal.

3 If the Service concludes that section 4 above properly applies and if the amount of the redetermination of DISC taxable income has been agreed upon, the shareholder will be requested to enter into a closing agreement, binding itself, the DISC, and any affected related supplier, establishing for each year involved:

(a) the amount of the redetermination of DISC taxable income;

(b) the amount of any actual distributions received by the shareholder which it elects to exclude from income under section 4.01 above;

(c) the amount of the account receivable from the DISC established by the DISC's related supplier under section 1.994-1(e)(5) of the regulations;

(d) the amount of the account receivable from the DISC's shareholder established by the related supplier under section 4.03 above; and

(e) the parties' rights to receive payment of the accounts receivable referred to in (c) and (d) above free of further Federal income tax consequences, provided such payments are made within the time and in the manner prescribed by section 1.994-1(e)(5) of the regulations.

.02 Cases pending before the United States Tax Court.—If a case has reached trial status in the Tax Court and it is determined that the taxpayer is entitled to the benefits of the provisions of section 4 above, the parties may stipulate or otherwise arrange with the Court so that any adjustment in tax for the years before the Court will reflect the application of section 4 above, provided the DISC's shareholder executes the required closing agreement.

.03 Closed cases.—In any closed case involving a redetermination of DISC income, the DISC's shareholder may file a request for the treatment provided by section 4 above, if such treatment will not change any taxpayer's liability for a year which is barred by the statute of limitations, or a year for which the tax liability has been finally determined by offer in compromise, closing agreement, or court action. Such request must be filed within 180 days after September 9, 1985, with the District Director for the District in which the shareholder filed its tax return for the year to which such redetermination relates, and shall contain the information required by section 5.011 above. The request will then be processed in the same manner as in a pending case described in sections 5.012 and 5.013 above.

.04 Cases within the jurisdiction of the Department of Justice.—If a taxpayer files a request for treatment under section 4 above with the appropriate District Director, with respect to a case within the jurisdiction of the Department of Justice, the Service, through its Chief Counsel, will recommend to the Department of Justice the action to be taken with respect to the taxpayer's request.

SEC. 6. EFFECTIVE DATE

This revenue procedure will be effective as of October 12, 1984, the date on which section 1.994-1(e)(5)(v) of the regulations was adopted in final form and was published in the Federal Register.

SEC. 7. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 84-3 is modified and superseded.

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26 CFR 601.602: Tax forms and instructions. (Also Part I, Sections 2511, 2512, 7872; 25.2511-1, 25.2512-1.)

Rev. Proc. 85-46

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide guidance in valuing and reporting gifts resulting from low-interest and interest-free demand loans for 1984 and prior years.

SEC. 2. BACKGROUND

.01 Section 2501 of the Internal Revenue Code imposes a tax on the transfer of property by gifts. Section 25.2511-1 of the Gift Tax Regulations provides that all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to gift tax. Section 25.2512-1 of the regulations provides that the value of the property transferred at the date of the gift is the amount of the gift. The value of the use of amoney subject to an interest-free demand note constitutes a gift for gift tax purposes. See Rev. Rul. 73-61, 1973-1 C.B. 408. In addition, the transfer of property in exchange for a note accruing interest at a rate below the prevailing market rate constitutes a gift for gift tax purposes. See *Blackburn v. Commissioner*, 20 T.C. 204 (1953), which held that the amount of the gift was the value of the property minus the mortgage note valued to reflect the present value of the deferral at prevailing interest rates.

.02 In *Dickman v. Commissioner*, 104 S. Ct. 1086 (1984), 1984-1 C.B. 197, the Supreme Court held that, in the case of an interest-free demand loan, a gift is made of the value of the use of the money loaned. While the Court did not decide the issue of valuation of such a gift, the Court did state that the right to use money is plainly a valuable right, readily measurable by reference to current interest rates. The Court also took notice of the fact that the interest rates for demand loans are ordinarily less than the interest rates for term certain loans.

.03 News Release IR-84-60, dated May 11, 1984, announced that for interest-free demand loan gifts made before January 1, 1984, donors may compute the value of the gifts by multiplying the average outstanding loan balance for the calendar period by interest rates that are based upon the lesser of either the statutory interest rate for refunds and deficiencies or the annual average rate for three month Treasury bills.

.04 News Release IR-84-60 also stated that the Service will not require gift tax reporting for interest-free demand loan gifts made before January 1, 1984, if the amount of the gift to a donee is less than the annual exclusion for the year, or if the average annual outstanding balance of the loan did not total, in the aggregate, more than $50,000 per year per donee made by a single taxpayer ($100,000 made by a married couple). News Release IR-84-60 was published as Announcement 84-60, 1984-23 I.R.B. 58, on June 4, 1984.

.05 Code Section 7872, which was enacted by the Tax Reform Act of 1984, (P.L. 98-369), 98 Stat. 699, provides special rules for valuing interest-free and other below market loan gifts made after the applicable effective date of that Act. Section 7872(c)(2) provides a de minimis exception rule for gift loans directly between individuals if the aggregate amount of all loans outstanding between the lender and borrower does not exceed $10,000.

SEC. 3. APPLICATION

.01 *Demand Loan Gifts—Years Affected.* A taxpayer who loans money on an interest-free demand basis makes a gift of the value of the use of the money loaned. In addition, a taxpayer who loans money on a demand basis at an interest rate below the prevailing market rate makes a low-interest demand loan gift of the value of the use of the money based on the difference between the rate at which the money is loaned and the prevailing market rate.

When the loan is payable upon demand, a gift occurs, the value of which is measured by the number of days that the loan is outstanding. Whether the loan is outstanding for an entire gift tax reporting period or for only part of a period, the gift of the value of the use of the money loaned is to be computed as of the end of the reporting period. A gift tax return for that period is requied to be filed if the value of the gift exceeds the limits described in section 3.05 of this procedure. See section 3.12 for the nonapplicability of these limits to gifts of future interests. Preceding gift tax reporting periods are 1) June 2, 1924, to December 31, 1924, June 6, 1932, to December 31, 1932; 2) calendar years 1925 and 1933 through 1970; 3) the first calendar quarter of 1971 and all intervening quarters through 1981; and 4) all calendar years after 1981.

.02 *Valuation of Demand Loan Gifts.* The value of a gift resulting from an interest-free demand loan outstanding before January 1, 1984, may be computed for any calendar period by multiplying the average outstanding loan balance for that period by the interest rate for the applicable year in the list in section 3.05 of this procedure. The value of a gift resulting from a low-interest demand loan outstanding before January 1, 1984, may be computed for any calendar period by multiplying the average outstanding loan balance for each loan for that period by the difference between the rate of interest on the gift loan and the interest rate for the applicable year in the list in section 3.05. The value of a gift for periods before the effective date of section 7872 resulting from an interest-free or low-interest demand loan outstanding during 1984 may also be computed by using the applicable interest rate or rates for 1984 from the list in section 3.05. A rate of 9.9% is to be used for computing the value of gifts for each day that such loans were outstanding from January 1, 1984, through June 6, 1984, and for each day after June 6, 1984, that such loans were outstanding provided that the loan was outstanding on June 6, 1984, and repaid before September 17, 1984. Interest-free and low-interest demand loans which were outstanding after June 6, 1984, whose interest rate provisions were modified before September 17, 1984, are treated as if repaid on the date of modification. See News Release IR-84-95, dated August 28, 1984. Accordingly, these loans may be valued using the 9.9% rate for the period beginning on January 1, 1984, and ending on the date of modification. Section 7872 governs interest-free and low-interest demand loans outstanding after June 6, 1984, through December 31, 1984 (unless such loans were outstanding on June 6, 1984, and repaid before September 17, 1984), and requires that a rate of 10 percent, compounded semiannually, be used for computing the value of gifts for each day in 1984 after June 6 that the loan is outstanding. In the case of loans outstanding after June 6, 1984, whose interest rate provisions were modified before September 17, 1984, section 7872 governs the loan beginning on the day following the date of modification. For special rules applicable to interest-free and low-interest demand loans outstanding both on and after June 6, 1984 (and not repaid or modified before September 17, 1984), see section 3.07 of this Revenue Procedure. The rates in section 3.05 are based upon the lesser of either the statutory rate for refunds and deficiencies or the annual average rate for 13-week Treasury bills.

.03 *De Minimis Demand Loan Principal Amounts.* For low-interest and interest-free demand loan principal amounts out-standing before January 1, 1984, if the average annual outstanding balance of the loans did not total, in the aggregate, more than $50,000 per year per donee made by a single taxpayer ($100,000 made by a married couple), no gift tax reporting for the loan gifts is required. Married couples who were qualified for the split-gift election under section 2513 of the Code in any gift tax period before 1984, in which a gift loan was outstanding but were not required to file a gift tax return for any gifts other than for gifts resulting from loans outstanding during that period, are not required to file a gift tax return if the only reason for filing would be to elect the split-gift provision for that period. This $50,000/100,000 de minimis rule does not apply to gifts resulting from low-interest and interest-free demand loans outstanding after December 31, 1983.

.04 *De Minimis Demand Loan Gifts.* For low-interest and interest-free demand loans outstanding before January 1, 1984, if the aggregate amount of the loan gifts to one donee is less than the annual exclusion for the year during which any loans were outstanding, no gift tax reporting for the gifts is required. The annual exclusion from a gift was $5,000 for years before 1939, $4,000 for the years 1939 through 1942, $3,000 for the years 1943 through 1981, and $10,000 thereafter. Low-interest and interest-free demand loans resulting in gifts to a donee which in the aggregate are not in excess of the annual exclusion may be disregarded for purposes of filing gift tax returns for periods before 1984, even though the donor made gifts other than gifts from low-interest and interest-free demand loans to the same donee during the same year.

For gifts resulting from low-interest and interest-free demand loans outstanding after December 31, 1983, this special exclusion rule does not apply. Thus, after December 31, 1983, if the aggregate amount of the loan gifts to one donee plus gifts other than gifts from low-interest and interest-free demand loans during the same year to that donee is greater than the annual exclusion for the year, a gift tax return is required to be filed.

.05 *Rates and De Minimis Gift and Principal Amounts.* Applicable interest rates and yearly minimum average annual interest-free loan amounts corresponding to the gift amount that equals the annual exclusion are as follows:

Year	Interest Rate	Gift Amount		Average Annual Interest-Free Loan Amount	
		Single Taxpayer	Married Taxpayer	Single Taxpayer	Married Taxpayer
1984 (before June 7)*	9.9%				
1983	8.6%	10,000	20,000	116,279	232,558
1982	10.6%	10,000	20,000	94,339	188,678
1981	12.0%	3,000	6,000	50,000	100,000
1980	11.5%	3,000	6,000	50,000	100,000
1979	6.0%	3,000	6,000	50,000	100,000
1978	6.1%	3,000	6,000	50,000	100,000
1977	5.2%	3,000	6,000	57,692	115,384
1976	4.9%	3,000	6,000	61,224	122,448
1975	5.8%	3,000	6,000	51,724	103,448
1974	6.0%	3,000	6,000	50,000	100,000
1973	6.0%	3,000	6,000	50,000	100,000
1972	4.0%	3,000	6,000	75,000	150,000
1971	4.3%	3,000	6,000	69,767	139,534
1970	6.0%	3,000	6,000	50,000	100,000
1969	6.0%	3,000	6,000	50,000	100,000
1968	5.3%	3,000	6,000	56,603	113,206
1967	4.3%	3,000	6,000	69,767	139,534
1966	4.8%	3,000	6,000	62,500	125,000
1965	3.9%	3,000	6,000	76,923	153,846
1964	3.5%	3,000	6,000	85,714	171,428
1963	3.1%	3,000	6,000	96,774	193,548
1962	2.7%	3,000	6,000	111,111	222,222
1961	2.3%	3,000	6,000	130,434	260,868
1960	2.9%	3,000	6,000	103,448	206,896
1959	3.4%	3,000	6,000	88,235	176,470
1958	1.8%	3,000	6,000	166,666	333,332
1957	3.2%	3,000	6,000	93,750	187,500
1956	2.6%	3,000	6,000	115,384	230,768
1955	1.7%	3,000	6,000	176,470	352,940
1954	.9%	3,000	6,000	333,333	666,666
1953	1.9%	3,000	6,000	157,894	315,788
1952	1.7%	3,000	6,000	176,470	352,940
1951	1.5%	3,000	6,000	200,000	400,000
1950	1.2%	3,000	6,000	250,000	500,000
1949	1.1%	3,000	6,000	272,727	545,454
1948	1.0%	3,000	6,000	300,000	600,000
1947	.5%	3,000	6,000	600,000	1,200,000
1946	.3%	3,000	6,000	1,000,000	2,000,000
1945	.3%	3,000	6,000	1,000,000	2,000,000
1944	.3%	3,000	6,000	1,000,000	2,000,000
1943	.3%	3,000	6,000	1,000,000	2,000,000
1942	.3%	4,000	8,000	1,333,333	2,666,666
1941	.1%	4,000	8,000	4,000,000	8,000,000
1940	.01%	4,000	8,000	40,000,000	80,000,000
1939	.02%	4,000	8,000	20,000,000	40,000,000

*This rate also applies to demand loans outstanding on and after June 6, 1984, if the loan was repaid before September 17, 1984, or, if its interest rate was modified before September 17, 1984, the interest rate is applicable up to the date of the modification. In the case of any other low-interest or interest-free demand loans outstanding after June 6, 1984, see section 3.07 of this Revenue Procedure.

Interest rates and corresponding average annual interest-free loan amounts for years prior to 1939 have not been included in the table because a combination of low interest rates during those years and a relatively high ($5,000) statutory annual exclusion creates a very high loan amount that would exempt all but a relatively few donors from the requirement to report low-interest or interest-free demand loan gifts made in years before 1939. The

interest rates for those years may be obtained by writing to the Associate Chief Counsel (Technical), 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

.06 *Illustrative Computations.* For years prior to 1984, the average annual (or quarterly) loan amount of an interest-free or low-interest demand loan is computed by multiplying the amount of each interest-free or low-interest demand loan made by the taxpayer (and the taxpayer's spouse, if applicable) to each donee which is outstanding during a gift reporting period by a fraction, the numerator of which is the number of days the loan is outstanding during that period and the denominator of which is the number of days in that reporting period. For 1984, the average annual loan amount is determined as in the case of pre-1984 loans, except that the numerator of the fraction is the number of days the loan was outstanding prior to June 7, 1984 (or prior to September 17, 1984, if the loan was repaid or its interest rate modified before September 17, 1984). For purposes of applying this revenue procedure, the number of days the loan is outstanding is calculated by including the day the loan is entered into but excluding the day the loan is repaid.

Number of days in the gift tax reporting periods:

For years prior to 1971, and for 1982, 1983, and 1984;

365—for annual reporting periods (366 for leap years).

For years 1971 through 1981:

90—for the first quarter (except 91 for the first quarter of 1972, 1976, and 1980)

91—for the second quarter

92—for the third quarter, and

92—for the fourth quarter.

Example A: An unmarried taxpayer, *T*, made an interest-free demand loan in the amount of $150,000 (loan 1), to child *A* on March 1, 1983. No payments were made by *A* until June 15, 1983, at which time the entire loan was repaid. On August 1, 1983, *T* made another interest-free demand loan to *A* in the amount of $200,000 (loan 2). *A* repaid $75,000 of loan 2 on September 10, 1983, leaving an outstanding principal amount of $125,000, none of which was repaid during 1983. On December 1, 1983, *T* made another interest-free demand loan to *A* in the amount of $50,000 (loan 3), none of which was repaid in 1983. The average annual loan amount for 1983 is computed as follows:

	Amount		No. of days outstanding divided by No. of days in reporting Period		Average Annual Loan Amount
Loan 1:	150,000	×	106/365	=	43,561.65
Loan 2:	200,000	×	40/365	=	21,917.80
	125,000	×	112/365	=	38,356.16
Loan 3:	50,000	×	30/365	=	4,109.59
Total Average Annual Loan Amount:					107,945.20

The average annual loan amount ($107,945.20) for the loans in 1983 is less than the limitation for a single taxpayer set forth in section 3.05 above. (The loans that contribute to the average annual loan amount constitute a gift to *A* of only $9,283.29 ($107,945.20 × 8.6%)). Therefore, *T* is not required to file a gift tax return for 1983 reporting the loans to *A*.

Example B: An unmarried taxpayer, *S*, made a demand loan to *C* of $100,000 at an interest rate of 8 percent (loan 1) on February 1, 1982. No payment was made by *C* until December 15, 1982, at which time the entire loan was repaid. On March 15, *S* made an interest-free demand loan to *2C* in the amount of $150,000 (loan 2) which was repaid in full by *C* on October 10, 1982. A third loan was made by *S* to *C* on June 15, in the amount of $175,000 at an interest rate of 6 percent (loan 3). This loan was not repaid by *C* during 1982. The average annual loan amount and the gift for 1982 are computed as follows:

	Amount		No. of days outstanding divided by No. of days in reporting period		Average Annual Loan Amount
Loan 1:	100,000	×	317/365	=	86,849.32
Loan 2:	150,000	×	209/365	=	85,890.41
Loan 3:	175,000	×	199/365	=	95,410.96

The gifts to *C* are determined by use of the interest rates in section 3.05 reduced by the interest rate actually charged on each respective loan and are computed as follows:

	Average Annual Loan Amount		Interest Rate		Gift
Loan 1:	86,849.32	×	2.6%	=	2,258.08
Loan 2:	85,890.41	×	10.6%	=	9,104.38
Loan 3:	95,410.96	×	4.6%	=	4,388.90
Aggregate Gift to *C*:					$15,751.36

Since the aggregate gift ($15,751.36) from loans to *C* during 1982 exceeded the limitation for a single taxpayer set forth in section 3.05 above, *S* is required to file a gift tax return reporting the loans to *C*.

Example C: A married taxpayer, *M*, made a demand loan of $125,000 at an interest rate of 8 percent (loan 1) to child *B* on January 15, 1980. No payment was made by *B* until June 10, 1980, at which time the entire loan was

repaid. On February 10, *M* made an interest-free demand loan to *B* in the amount of $80,000 (loan 2) which was not repaid by *B* during 1980. *M* made another interest-free demand loan to *B* on March 1, 1980, in the amount of $175,000 which was repaid by *B* on December 15, 1980. Gifts are determined on a quarterly basis for 1980 because gift tax returns were required to be filed on a quarterly basis for that year. The average quarterly loan amount for the first quarter of 1980 is computed as follows:

	Amount		No. of days outstanding divided by No. of days in reporting period		Average Quarterly Loan Amount
Loan 1:	125,000	×	76/91	=	104,395.60
Loan 2:	80,000	×	50/91	=	43,956.04
Loan 3:	175,000	×	30/91	=	57,692.30

	Average Quarterly Loan Amount		Average Annualized Loan Amount		Interest Rate		Gift
Loan 1:	104,395.60 × ¼	=	26,098.90	×	3.5%	=	913.46
Loan 2:	43,956.04 × ¼	=	10,989.01	×	11.5%	=	1,263.74
Loan 3:	57,692.30 × ¼	=	14,423.08	×	11.5%	=	1,658.65
	Aggregate Gift to *B*:						3,835.85

Since the amount of the aggregate gift for loans made to *B* by *M* in the first quarter of 1980 is $3,835.85 and does not exceed the annual limitation for a married taxpayer set forth in section 3.05 above, *M* is not required to file a quarterly gift tax return reporting the loans to *B* for the first quarter of 1980. However, *M* would be required to file quarterly gift tax returns for any subsequent quarter of 1980 in whhich the aggregate loan amount of prior quarters in 1980 plus the current quarter amount exceeds the limitations of section 3.05 above, taking into consideration the quarterly gift tax filing requirement under section 6075(b) of the Code as in effect in 1980 which required a quarterly return (rather than a yearly return) for a donor whose aggregate year-to-date gifts exceeded $25,000.

.07 *Coordination with Section 7872.* Interest-free and low-interest demand gift loans outstanding after June 6, 1984, are subject to the rules of section 7872 after June 6, 1984, unless the demand loan is repaid or the interest rate is modified before September 17, 1984. Interest-free and low-interest demand loans which were outstanding on June 6, 1984, whose interest rate provisions were modified before September 17, 1984, are subject to section 7872 beginning on the date of modification. For purposes of maiing gift tax computations, an interest-free or low-interest loan outstanding both on and after June 6, 1984, but not repaid or modified before September 17, 1984, is treated as if it was repaid on June 7, 1984 (the "first deemed loan"), and a new loan between the same parties with the same terms was entered into on June 7, 1984 (the "second deemed loan"). The amount of the loan gift with respect to the first deemed loan is determined under the rules set forth in this Revenue Procedure. The amount of the loan gift with respect to the second deemed loan is determined under section 7872. The loan gift amount for the entire year is the sum of the loan gift amounts of both deemed loans.

In the case of an interest-free demand loan of fixed principal amount which is outstanding for the entire 1984 calendar year, the donor may, as an alternative to the approach described in the above paragraph, determine the loan gift amount for 1984 by multiplying the outstanding balance by an ianterest rate of 10 percent. In the case of an interest-free demand loan of fixed principal amount outstanding for the entire period of June 7 through December 31, 1984, the donor may, as an alternative to the calculations described in the regulations under section 7872, determine the loan gift amount by multiplying the outstanding balance by an interest rate of 5.68 percent.

Example A: An unmarried taxpayer, *P*, made an interest-free demand loan in the amount of $150,000 to child *D* on January 15, 1984, which remained outstanding on December 31, 1984. The gift to *D* is determined by treating the loan as if it was repaid on June 7, 1984, and a second interest-free demand loan in the amount of $150,000 was entered into on June 7, 1984. As to the first loan deemed repaid on June 7, 1984, the average annual loan amount is computed as follows:

$150,000 × 144/366 = $59,016.39

The amount of the gift as to this first loan is $5,842.62

($59,016.39 × 9.9%).

Section 7872 governs the second loan deemed to have been made on June 7, 1984. However, because the second deemed loan is outstanding for the entire period June 7 through December 31, 1984, the amount of the loan gift with respect to this second loan may be determined by multiplying the outstanding principal amount ($150,000) by 5.68 percent, resulting in a loan gift of $8,520.00.

The loan gift to *D* for 1984 is the sum of the two deemed loan gift amounts, or $14,362.62 ($5,842.62 + $8,520.00).

Example B: Assume the same facts as in Example A except that the loan is already outstanding on January 1, 1984. Because the loan is outstanding for the entire 1984 calendar year, the taxpayer may value the loan gift amount by multiplying the outstanding balance by 10 percent, resulting in a loan gift amount of $15,000.00.

.08 *Demand Loans other than De Minimis Loans.* A donor is entitled to one statutory annual exclusion for qualifying gifts per donee per year. If part or all of the annual exclusion was ap-

plied to gifts, other than gifts resulting from low-interest and interest-free demand loans, made by the donor to the donee, only the remaining exclusion amount, if any, may be applied to gifts resulting from low-interest and interest-free demand loans that are not de minimis.

.09 *Gift Tax Return not Previously Filed.* If no gift tax return was filed for any prior taxable period during which the aggregate annualized amount of interest-free demand loans outstanding to one donee exceeded the average annual loan amount in section 3.05 above, the gift must be reported on a properly filed gift tax return and any gift tax due must be paid. Also, if the gifts from both outstanding low-interest and interest-free demand loans total in the aggregate more than the gift amount in section 3.05 above, and no gift tax return was filed for that prior taxable period, the gift must be reported and any gift tax due must be paid.

If the gifts from low-interest and interest-free demand loans to a donee outstanding in a year after December 31, 1983, and other present interest gifts to that donee made in the same year total in the aggregate more than the statutory annual exclusion amount, the gift(s) must be reported and any gift tax due must be paid.

.10 *Gift Tax Return Previously Filed.* If a gift tax return was filed for any period prior to 1984 during which the aggregate annualized amount of outstanding interest-free demand loans exceeded the average annual loan amount in section 3.05 or the aggregate gifts resulting from outstanding low-interest and interest-free demand loans exceeded the gift amount in section 3.05 and any gift resulting from such loans was not reported on the gift tax return, the gift must be reported on an amended gift tax return properly filed within the statutory limitations for assessment under section 6501 of the Code and any gift tax due must be paid. If a gift tax return was filed for any year which ends after December 31, 1983, during which an interest-free or low-interest demand loan to the donee was outstanding and the total gifts resulting from such loans, and any other present interest gifts to that donee exceeded the statutory $10,000 annual exclusion amount, the gift(s) must be reported on a properly filed amended gift tax return.

.11 *Refunds for de minimis loan gift or overvaluation.* If in any year before 1984, the donor made low-interest or interest-free demand loan gifts that did not in the aggregate exceed the statutory annual exclusion amount for that year and if a gift tax return was filed for that period reporting any such loan gift, a refund of any gift tax paid attributable to the outstanding low-interest and interest-free demand loans may be claimed, but only if the year is one for which a refund claim would otherwise be considered timely filed within the limitation period for refunds allowed under section 6511 of the code. A refund may also be claimed for the excess gift tax paid for any demand loan gift that was reported in a previously filed gift tax return if the gift was valued on the basis of a valuation in excess of the valuation determined pursuant to sections 3.02 and 3.05, but only if the year is one for which a refund claim would otherwise be considered timely filed within the limitation period for refunds allowed under section 6511 of the Code.

.12 *Treatment of De Minimis Loan Gifts in Subseuqent Tax Returns.* Gifts made before January 1, 1984, that resulted from low-interest and interest-free demand loans outstanding in prior gift tax periods of no more than the average annual loan amounts for those periods set forth in section 3.05, will be disregarded for purposes of computing the gift tax on the donor's gifts made in years subsequent to such loans and in computing the estate tax on the donor's estate. However, reportable gifts resulting from low-interest and interest-free demand loans outstanding after December 31, 1983, will not be disregarded for purposes of computing the donor's gift tax in subsequent years and the donor's estate tax.

.13 *Indirect Gift Loans.* Low-interest and interest-free demand loans made to trusts or other entities are treated for purposes of this revenue procedure as separate loans made proportionately to those individuals who have a beneficial interest in the trust or other entity. The exceptions set forth in sections 3.03 and 3.04 apply only to individuals who have a present interest in the loan proceeds or the income attributable to the loan proceeds. If the low-interest or interest-free demand loan is transferred to a trust or other entity for the benefit of a donee who is under age 21, te donee is not considered to have a future interest in the income attributable to the loan proceeds for any period during which the gift loan is outstanding and the donee is under age 21, if a) the income from the loan proceeds may be expended by or for the benefit of the donee prior to attaining age 21, b) any portion of the income attributable to the loan proceeds so disposed of will pass to the donee upon attaining the age of 21, and c) any portion of the income of the loan proceeds not disposed of in such manner prior to the donee attaining age 21, will be payable either to the estate of the donee or as the donee may appoint under a general power of appointment as defined in Code section 2514(c) if the donee dies before attaining the age of 21 years.

SEC. 4. EFFECTIVE DATE

This revenue procedure is effective September 16, 1985, the date of its publication.

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26 CFR 601.602: Tax forms and instructions.

Rev. Proc. 85-47

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NOTE: THIS REVENUE PROCEDURE MAY ONLY BE USED TO PREPARE MAGNETIC DISKETTE SUBMISSIONS FOR TAX YEAR 1985. UPDATED COPIES ARE PUBLISHED EACH YEAR. PLEASE READ THIS PUBLICATION CAREFULLY; **YOU MAY BE SUBJECT TO PENALTIES IF YOU FAIL TO FOLLOW THE INSTRUCTIONS IN THIS REVENUE PROCEDURE.** THESE INCLUDE PENALTIES OF $50 PER DOCUMENT FOR EACH DOCUMENT SUBMITTED WITHOUT A TAXPAYER IDENTIFICATION NUMBER (TIN) OR WITH AN INCORRECT TIN, AND FOR EACH DOCUMENT NOT SUBMITTED ON MAGNETIC MEDIA IF YOU ARE REQUIRED TO FILE THIS WAY. THE MAXIMUM PENALTY IS $50,000 (PAYERS OF INTEREST AND DIVIDENDS ARE NOT SUBJECT TO THIS MAXIMUM.)

PART A.—GENERAL

SECTION 1. PURPOSE

.01 The purpose of this revenue procedure is to provide the requirements and conditions for filing information return Forms 1098, 1099, 5498, and W-2G on diskette. *THIS REVENUE PROCEDURE IS TO BE USED FOR THE PREPARATION OF TAX YEAR 1985 INFORMATION RETURNS ONLY.* THIS PROCEDURE IS UPDATED YEARLY TO REFLECT NECESSARY CHANGES. PLEASE READ THIS PUBLICATION CAREFULLY. Specifications for filing the following forms are contained in this procedure:

(a) Form 1098, Mortgage Interest Statement.

(b) Form 1099-A, Information Return for Acquisition or Abandonment of Secured Property.

(c) Form 1099-B, Statement for Recipients of Proceeds from Broker and Barter Exchange Transactions.

(d) Form 1099-DIV, Statement for Recipients of Dividends and Distributions.

(e) Form 1099-G, Statement for Recipients of Certain Government Payments.

(f) Form 1099-INT, Statement for Recipients of Interest Income.

(g) Form 1099-MISC, Statement for Recipients of Miscellaneous Income.

(h) Form 1099-OID, Statement for Recipients of Original Issue Discount.

(i) Form 1099-PATR, Statement for Recipients (Patrons) of Taxable Distributions Received From Cooperatives.

(j) Form 1099-R, Statement for Recipients of Total Distributions from Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, Etc.

(k) Form 5498, Individual Retirement Arrangement Information.

(l) Form W-2G, Statement for Recipients of Certain Gambling Winnings.

.02 This procedure also provides the requirements and specifications for diskette filing under the Combined Federal/State Filing Program. Refer to Part A, Sec. 14.

.03 The following revenue procedures and publications provide more detailed filing procedures for certain information returns, payer identification,

transfer agents and paper substitute specifications, respectively.

(a) 1985 "Instructions for Form 1099 Series, 1098, 5498, and 1096," provide further information on filing returns with the Internal Revenue Service (IRS). These instructions are available at local IRS offices.

(b) Rev. Proc. 84-24, 1984-1 C.B. 465, regarding preparation of transmittal documents for information returns.

(c) Rev. Proc. 84-33, 1984-1 C.B. 502, regarding the optional method for agents to report and deposit backup withholding.

(d) Publication 1179, Requirements for Reproducing Paper Substitutes of Forms 1096, 1099 series, 5498, W-2G and W-3G. A supplement will be issued to include instructions for substitutes of Form 1098, Mortgage Interest Statement.

.04 This procedure supersedes the following revenue procedure: Rev. Proc. 84-68, 1984-2 C.B. 638, also published in Publication 1255 Rev. (10-84), Requirements and Conditions for Filing Information Returns in the Forms 1099, 5498, and W-2G Series on Magnetic Diskette.

.05 Refer to Part A, Sec. 15 for definitions of terms used in this publication.

SEC. 2. BACKGROUND—PRIOR YEAR CHANGES (TAX YEAR 1984)

.01 This section contains a *review* of the changes described in the revenue procedure last year. *Please* insure that the necessary reprogramming was accomplished in order to comply with last year's changes as these changes will still be necessary in the program for the current year.

.02 The following were general changes:

(a) Procedures for applying for waivers for undue hardship were added.

(b) An explanation of penalties was added.

(c) Reports from different branches for one payer were consolidated under one Payer/Transmitter "A" Record for each type of information return. For example, all like Form 1099-INT documents must be sorted together under one Payer/Transmitter "A" Record, followed by the appropriate Payee "B" Records and one End of Payer "C" Record.

(d) The explanation of Taxpayer Identification Numbers (TINs) was rewritten to clarify changes concerning backup withholding and due diligence requirements.

(e) Changes were made to the requirements concerning the paper copy of the information return furnished to the payee.

(f) A definition for "Transfer Agent" was added.

(g) A list of valid U.S. Postal Service State Abbreviations was added to aid in developing the State Code portion of Name Line fields.

.03 The following changes were made to the Payer/Transmitter "A" Record:

(a) Amount Indicator "2" was added for Form 5498.

(b) "Type of Return" and "Amount Indicators" were added for Form W-2G.

(c) The codes for "Type of Payer" and "Payee 'B' Record Surname Indicator" fields should have been deleted from your programs. However, the positions in the record *should not* have been deleted. Fill these positions with blanks.

(d) The "Second Payer Name" field was shortened from 40 characters to 39 characters. The contents of the "Second Payer Name" field, as well as the contents of the "Payer Shipping Address" and the "Payer City, State and ZIP Code" fields, are dependent upon the value in the "Transfer Agent Indicator".

(e) A "Transfer Agent Indicator" was added following the "Second Payer Name" field. The contents of this field let IRS programs know if the information in "Second Payer Name", "Payer Shipping Address" and "Payer City, State and ZIP Code" pertains to the Payer or to the Transfer Agent.

(f) The name of "Payer Mailing Address" was changed to "Payer Shipping Address." Beginning with Tax Year 1984 returns, IRS notified payers of any information returns not containing valid TINs. This notification includes a payee notice for each such information return. Therefore, we must have an address capable of accepting volume mail.

.04 The following changes were made to the Payee "B" Record:

(a) The meaning of the "Document Specific Code" for Form 1099-G was expanded.

(b) The use of the "Document Specific Code" was increased to include Type of Wager for Form W-2G.

(c) PLEASE NOTE: If any one Payment Amount Field exceeds "9999999999" (dollars and cents), as many SEPARATE Payee "B" Records as necessary to contain the total MUST be submitted for the Payee. Example: the total money amount to be reported for Payee ABC is $250,371,491.87. Three Payee "B" Records will have to be submitted for Payee ABC to contain the entire total amount. (DO NOT enter dollar signs, commas, or decimal points, in the Payment Amount fields.)

(d) New field definitions specific to Form W-2G were added.

SEC. 3. NATURE OF CHANGES—CURRENT YEAR (TAX YEAR 1985)

.01 DUE TO *NUMEROUS* LEGISLATIVE AND FORMS CHANGES BETWEEN TAX YEARS 1984 AND 1985, CHANGES HAVE *NOT* BEEN LISTED INDIVIDUALLY UNDER THIS SECTION. THIS ENTIRE PUBLICATION HAS BEEN REVISED. REVIEW THIS REVENUE PROCEDURE IN ITS *ENTIRETY*.

SEC. 4. WAGE AND PENSION INFORMATION FILED WITH SSA

.01 Section 8(b), Public Law 94-202, 1976-1 C.B. 503, enacted in January 1976, authorized the combined reporting of FICA detailed information in one consolidated annual W-2 (Copy A) to the Federal government. AS A RESULT, FORMS W-2 AND W-2P ARE TO BE FILED WITH THE SOCIAL SECURITY ADMINISTRATION (SSA), NOT WITH THE INTERNAL REVENUE SERVICE.

.02 SSA will accept magnetic media filing of Forms W-2 and W-2P and has issued the following concerning this: TIB-4a, "*Magnetic Tape Reporting*, Submitting FICA Wage and Tax Data to the Social Security Administration"; TIB-4b, "*Magnetic Tape Reporting*, Submitting Annuity, Pension, Retired Pay or IRA Payment to the Social Security Administration"; and TIB-4c, "*Diskette Reporting*, Submitting FICA Wage and Tax Data to the Social Security Administration". Applications for

filing Forms W-2 and W-2P on magnetic media appear in TIBs-4a, 4b, and 4c.

.03 Copies of Social Security Administration publications TIB-4a, 4b, and 4c are available from any local Social Security Administration Office or the SSA Regional Magnetic Media Coordinators.

SEC. 5. APPLICATION FOR MAGNETIC MEDIA REPORTING AND REQUESTS FOR UNDUE HARDSHIP WAIVERS

.01 For purposes of this revenue procedure, the *PAYER* is the organization making the payments and the *TRANSMITTER* is the organization preparing the diskette file. The payer and transmitter may be the same organization. Payers or their transmitters are required to complete Form 4419, Application for Magnetic Media Reporting of Information Returns. A copy of this form, for your use, can be found at the end of this publication. Requests for additional information or forms relating to magnetic media processing should be addressed to the Magnetic Media Coordinator at the appropriate service center or the National Computer Center.

On January 1, 1985, the National Computer Center assumed responsibility for the magnetic media processing previously handled by the Philadelphia, Kansas City, and Austin Service Centers. Beginning January 1, 1986, magnetic media processing for *ALL* service centers will be centralized at the National Computer Center. Addresses are listed in Part A, Sec. 13 of this revenue procedure.

.02 Applications should be filed with the National Computer Center or the appropriate service center 90 days before the due date of the return. IRS will act on an application and notify the applicant, in writing, of authorization to file. A five character *Transmitter Control Code* will be assigned and included in an acknowledgement letter within 30 days of receipt of the application. Diskette returns may not be filed with IRS until the application has been approved. Do not enter blanks in the "A" Record Transmitter Control Code field; enter the five character Transmitter Control Code which is assigned to you by IRS after you have filed an application and it has been approved.

.03 After you have received approval to file on magnetic media, you do not need to reapply each year *UNLESS:*

(a) there are hardware or software changes that would affect the characteristics of the magnetic media submission (e.g., changing from diskette to tape filing or vice versa) or,

(b) you discontinue filing on magnetic media for a year (your five character Transmitter Control Code may be reassigned).

If either of these conditions applies to you, you should contact your coordinator for clarification. In *ALL* correspondence, refer to your current five character Transmitter Control Code to assist the coordinator in locating your files.

.04 IRS will assist new filers with their initial diskette submission by reviewing *"test"* files submitted in advance of the filing season. Approved payers or transmitters should submit *"test"* files with the Magnetic Media Coordinator at the appropriate service center or the National Computer Center. You *MUST* submit a *"test"* file in order to participate in the Combined Federal/State Program; however, you are encouraged to submit *"test"* files if you are a new filer on magnetic media. As a guideline, IRS prefers that all *"test"* files be submitted between September and December. Refer to Part A, Sec. 13 for addresses. Do not submit *"test"* diskettes after January 1. If you are unable to submit your *"test"* file by the end of December, you may *only* send a sample hardcopy printout or diskette dump to the National Computer Center which shows a sample of each record (A, B, C, K and F) *used.*

Clearly mark the hardcopy printout or diskette dump as "TEST DATA", and include identifying information such as name, address and telephone number of someone familiar with the *"test"* print or diskette dump who may be contacted to discuss its acceptability. After January 1, 1986, submit the *"test"* print or diskette dump showing a sample of each record to the National Computer Center only.

.05 If your magnetic media files have been prepared for you in the past by a service agency, and you now have computer equipment compatible with that of IRS and wish to prepare your own files, you must request your own five character Transmitter Control Code by filing an application, Form 4419, as described above.

.06 If you as an individual or organization are an approved filer on magnetic media and you change your name or the name of your organization, please notify the National Computer Center or service center Magnetic Media Coordinator so that your file may be updated to reflect the proper name.

.07 In accordance with section 1.6041-7 (b) of the Income Tax Regulations, payments to providers of medical and health care services from separate departments of a health care carrier may be reported as separate returns on magnetic media. In this case, the headquarters office will be considered to be the transmitter, and the individual departments of the company filing reports will be considered to be payers. A *single* application form covering *all* the departments which will be filing on diskette should be submitted. One five character Transmitter Control Code may be used for all departments.

.08 Section 1.6045-1(1) of the Income Tax Regulations requires brokers and barter exchanges to use magnetic media in reporting all Form 1099-B data to the IRS. Generally, *NEW* brokers and *NEW* barter exchanges may request an undue hardship exception by filing an application, by the end of the second month following the month in which they became a broker or barter exchange, with the National Computer Center or service center Magnetic Media Coordinator.

.09 *All* requests for undue hardship exemptions should be submitted at least 90 days before the due date of the return, except as stated in Sec. 5.08 above.

.10 The requirements to receive a waiver from filing *required* information returns on magnetic media for tax year 1985 are more stringent than they were for tax year 1984. Filers must submit a *written* statement requesting an undue hardship waiver from magnetic media filing for a specific period of time, not to exceed one tax year. If the filer requires a waiver for a longer period of time, the filer must reapply at the appropriate time each year (90 days before the due date of the return). Filers may not apply for a waiver for more than one tax year at a time. The written statement *must* contain the following identifying information:

(a) The filer's name and address.

(b) The filer's Taxpayer Identifica-

tion Number (SSN or EIN).

(c) The period for which the waiver is requested: Tax Year 1985.

(d) The name and telephone number of a person to contact who is familiar with the information contained in the waiver request.

(e) The type of returns and expected volume of each form.

(f) The reason for the request.

(g) An estimated cost for filing the returns on paper, on magnetic media if *you* prepare the files, and on magnetic media using the services of an agency who will charge you for this service. IF YOU EXPECT TO FILE OVER 500 RETURNS, YOU *MUST* SUBMIT A COPY OF A WRITTEN COST ESTIMATE FOR MAGNETIC MEDIA FILING FROM A SERVICE AGENCY; FOR 500 OR LESS, SUBMIT AN ESTIMATE AS DESCRIBED ABOVE.

.11 If you request a waiver from filing on magnetic media and it *is* approved, *do not send a copy of the approved waiver to the service centers.* Do *not* staple, paperclip or use rubber bands on any scannable forms. Paper returns are read by an optical scanner (OCR) at the service centers.

.12 Waivers are granted on a case-by-case basis and may be approved at the discretion of the service center or National Computer Center Magnetic Media Coordinators. Refer to Part A, Sec. 13 for addresses. Waiver requests should be filed 90 days before the due date of the return, except as stated in Sec. 5.08 above.

.13 If you are required to file on magnetic media but fail to do so, and you do not have an approved waiver on record, you may be subject to a failure to file penalty. Refer to Sec. 6.02 below.

.14 *An approved waiver from filing information returns on magnetic media does not provide exemption from ALL filing; you MUST submit your information returns on acceptable paper forms.*

.15 A diskette reporting package, which includes all the necessary transmittals, labels, and instructions, will be mailed to all approved filers between October and December of each year.

SEC. 6. FILING OF MAGNETIC MEDIA REPORTS

.01 Section 6011(e) of the Internal Revenue Code, as amended by the Interest and Dividend Tax Compliance Act of 1983, Pub. L. 98-67, 1983-2 C.B. 352, requires that any person, including individuals, estates and trusts, required to file more than 50 information returns in the aggregate for payments of interest (Forms 1099-INT and 1099-OID), dividends (Form 1099-DIV) or patronage dividends (Form 1099-PATR) for any calendar year, must file such returns on magnetic media. For example, if a payer must file 30 Forms 1099-DIV and 25 Forms 1099-INT, filing on magnetic media is required. This requirement shall not apply if you establish that it will cause you undue hardship.

.02 The penalty for both the failure to timely file certain information returns and failure to file returns as prescribed by IRS is now $50 per payee up to a maximum of $50,000 a year. However, there is no maximum penalty for returns of 1099-INT, 1099-OID, 1099-DIV, 1099-PATR or 5498. If the failure to file is due to intentional disregard of the filing requirements, the penalty may be greater than $50 per payee and there is no maximum penalty.

.03 Generally, payers are now subject to a $50 penalty for *each* failure to include the payee's correct TIN on an information return.

.04 Rev. Proc. 84-24, 1984-1 C.B. 465, gives detailed information on preparing transmittal documents for information returns and is available at your local IRS office. Specific guidelines are given on how to report the payer's name, address and TIN on transmittal documents and information returns. Instructions for multiple transmittals and the submission of transmittals by service bureaus or agents are also covered.

.05 *THE DISKETTE RECORDS ARE TO BE SUBMITTED TO THE NATIONAL COMPUTER CENTER; HOWEVER, PAPER INFORMATION RETURNS ARE TO CONTINUE TO BE FILED WITH THE APPROPRIATE SERVICE CENTERS. See Part A, Sec. 13 for addresses.* Form 4804, Transmittal of Information Returns Reported on Magnetic Media, must accompany diskette submissions. If you file for multiple payers and have the authority to sign the affidavit on Form 4804, you should also submit Form 4802, Multiple Payer Transmittal for Magnetic Media Reporting.

For the IRS to ensure that your actual data records were formatted following THIS revenue procedure, include a hardcopy printout, fast print or diskette dump showing a sample of each type of record (A, B, C, K and F) used on the diskette. This will be reviewed prior to actual processing to ensure that the data is in the proper format. Be sure to include Form 4804, 4802, or computer generated listing *with* your diskette shipment. IRS encourages the use of computer generated Form 4804 which includes *all* necessary information requested on the actual form. *DO NOT MAIL THE DISKETTES AND THE TRANSMITTAL DOCUMENTS SEPARATELY.*

Paper information returns must be transmitted to the appropriate service center using Form 1096, Annual Summary and Transmittal of U.S. Information Returns. *Do not send information returns filed on paper forms to the National Computer Center.*

.06 The affidavit which appears on Form 1096 and Form 4804 should be signed by the payer; however, the transmitter, service bureau, paying agent, or disbursing agent may sign the affidavit on behalf of the payer if all of the following conditions are met:

(a) It has the authority to sign the affidavit under an agency agreement (either oral, written, or implied) that is valid under the state law.

(b) It has the responsibility (either oral, written, or implied) conferred on it by the payer to request the TINs of borrowers, recipients, or participants reported on magnetic media or paper returns.

(c) It signs the affidavit and adds the caption "For: (name of payer)."

.07 Although a duly authorized agent signs the affidavit, the payer is held responsible for the accuracy of the Form 4804, and the payer will be liable for penalties for failure to comply with filing requirements.

.08 If a portion of the returns are submitted on paper documents with the service center, include a statement on the Form 1096 that the remaining returns are being filed on magnetic media with the National Computer Center. DO NOT REPORT THE SAME INFORMATION ON PAPER FORMS THAT YOU REPORT ON MAG-

NETIC MEDIA. IF YOU REPORT PART OF YOUR RETURNS ON PAPER AND PART ON MAGNETIC MEDIA, BE SURE THAT DUPLICATE RETURNS, WITH THE SAME INFORMATION, ARE NOT INCLUDED ON BOTH. This does not mean that corrected documents are not to be filed. If a return has been prepared and submitted improperly, you must file a corrected return as soon as possible. Refer to Part A, Sec. 10 for requirements and instructions on filing corrected returns.

.09 Reports from different branches for one payer *MUST* be consolidated under one Payer/Transmitter "A" Record for each type of information return. For example, all Forms 1099-INT must be sorted together under one Payer/Transmitter "A" Record followed by the appropriate "B" Records and one "C" Record.

.10 Health care carriers, or their agents, filing Form 1099-MISC per Part A, Sec. 5.07, may submit part of their returns on paper documents and part on magnetic media if the records of some departments are not maintained on computer files. However, an information return is required if the aggregate amount paid to a health care service provider from all departments equals $600 or more. For example, Department A pays $200, Department B pays $300, and Department C pays $100 to the same health care service provider. The aggregate amount paid from all departments equals $600. The health care carrier or agent must submit either one information return for the aggregate amount of $600 or three separate returns from the departments, indicating the amount paid by each department.

.11 Before submitting magnetic media files, include the following:

(a) A signed Form 4804 or computer generated substitute. If you send *two* copies of the Form 4804, one will be used as an acknowledgement.

(b) A Form 4802 (if you transmit for multiple payers).

(c) A hard copy printout or listing of the first five and last two blocks of your file. The listing should show a sample of each type of record (A, B, C, K and F) used on the magnetic media being submitted.

(d) The magnetic media with an external identifying label as described in part B, Sec. 1.

(e) On the outside of the shipping container, include a Form 4801 or a substitute for the form which reads "DELIVER UNOPENED TO TAPE LIBRARY—MAGNETIC MEDIA REPORTING—BOX ____ of ____." If there is only one container, mark the outside as Box *1* of *1*. For multiple containers, include the sequence (i.e., Box *1* of *33*, *2* of *33*, etc.).

(f) If you were granted an extension and are filing late, include a copy of the approved extension letter with the magnetic media.

.12 IRS will not pay or accept "Collect on Delivery" or "Charged to IRS" shipments of reportable tax information that an individual or organization is legally required to submit. The current policy is to return magnetic materials or requested information from the IRS, at U.S. Government expense.

.13 Files returned to you due to coding or format errors are to be corrected and returned to IRS within 30 days of receipt by the filer.

SEC. 7. FILING DATES

.01 The dates prescribed for filing paper returns with IRS also apply to magnetic media filing. Magnetic media reporting to the IRS for all types of Form 1098, 1099 Series, 5498, and W-2G must be on a calendar year basis.

.02 Information returns filed on magnetic media for Forms 1098, all types of Forms 1099, and W-2G must be submitted to IRS by February 28. The due date for furnishing the required copy or statement to the recipient is January 31.

.03 Information returns filed on magnetic media for Form 5498 must be submitted to IRS by May 31. Copies of this form or statements are due to the participant by May 31 for contributions made to IRAs and SEPs; however, participant copies or statements for DECs are due the time the contribution is made or January 31, whichever is the later. Form 5498 is filed for contributions to be applied to 1985 that are made between January 1, 1985, and April 15, 1986.

SEC. 8. EXTENSIONS OF TIME TO FILE

.01 If a payer or transmitter of returns on magnetic media is unable to submit their magnetic media file by the dates prescribed in Sec. 7.02 and 7.03 above, submit a letter requesting an extension of up to 30 days to file, as soon as you are aware that an extension will be necessary. The request *MUST* be filed *before* the due date of the return. The letter should be sent to the attention of the Magnetic Media Reporting Program at the National Computer Center where the diskette file is to be submitted. See part A, Sec. 13 for the address. The request should include:

(a) The filer's name and address.

(b) The filer's Taxpayer Identification Number (SSN or EIN).

(c) The tax year for which the extension of time is requested: tax year 1985.

(d) The name and telephone number of a person to contact who is familiar with the request.

(e) The type of returns and expected volume.

(f) The Transmitter Control Code assigned to the organization or individual requesting the extension (if a number has been assigned).

(g) The reason for the delay and date that you *will* be able to file.

.02 If an extension of time to file on magnetic media is granted by the National Computer Center, a *copy* of the letter *granting the extension MUST* be attached to the transmittal Form 4804 or computer generated substitute when the file is submitted.

SEC. 9. PROCESSING OF MAGNETIC MEDIA RETURNS

.01 The National Computer Center will process tax information from magnetic media files. All magnetic media files that are received timely by the National Computer Center will be returned to the filers by August 15 of the year in which submitted.

.02 After January 1, 1986, all magnetic media processing will be centralized at the National Computer Center. Due to the volume of input received and the cost to return special containers, special shipping containers should not be used for transmitting data to the National Computer Center since IRS cannot guarantee return of such containers.

.03 Files will be returned to you for correction if they are unprocessable due to format or coding errors, or by the re-

quest of the filer. Files must be corrected and returned to the National Computer Center within 30 days of receipt by the filer. The corrected files will be returned to the filer by the National Computer Center within 6 months of receipt. PLEASE BE SURE THAT YOUR FORMAT AND CODING COMPLY WITH THIS REVENUE PROCEDURE. *THIS REVENUE PROCEDURE IS TO BE USED FOR THE PREPARATION OF TAX YEAR 1985 INFORMATION RETURNS ONLY.* AS SOME LEGISLATIVE AND FORMS CHANGES AFFECTING INFORMATION RETURNS OCCUR EACH YEAR, THIS PROCEDURE IS UPDATED TO REFLECT NECESSARY CHANGES. PLEASE READ THIS PUBLICATION CAREFULLY.

SEC. 10. HOW TO FILE CORRECTED RETURNS

.01 If a return has been prepared and submitted improperly, you must file a complete corrected return as soon as possible. *ALL FIELDS OR BOXES MUST BE COMPLETED WITH THE CORRECT INFORMATION, NOT JUST THE DATA FIELDS NEEDING CORRECTION.* If you file corrected returns on paper forms, submit Copy A to the appropriate service center. There are numerous types of errors. It may require more than one transaction to properly correct the initial error. You are strongly encouraged to read this *ENTIRE* section before attempting to make *ANY* correction. If the initial return was filed as an aggregate, you must consider this in filing the corrected returns.

.02 Corrected returns submitted to IRS on magnetic media, using a "G" coded Payee "B" Record, may be submitted on the same diskette as those corrections submitted *without* the "G" code; however, they must be submitted using a separate "A" Record. Corrected returns for different tax years may not be submitted on the same file. Corrected returns are to be identified as corrections on the transmittal document and the *EXTERNAL* label of the file.

.03 The instructions that follow will provide information on how to file corrected returns on magnetic media *and* on paper forms. Please refer to the appropriate chart *and* type of error for instructions on how to *properly* file the corrected return(s).

.04 You may file corrected returns on paper forms; however, you are encouraged to file on magnetic media if you file *more* than 50 corrected returns.

.05 If you file your corrected returns on paper forms, do not submit the paper returns to the National Computer Center. *All paper returns, whether original or corrected, must be filed with the appropriate service center. Corrected returns filed on magnetic media must be filed with the National Computer Center.* Refer to Part A, Sec. 13 for address information.

.06 Statements to the recipient or participant should be identified as "CORRECTED" and should be provided to them as soon as possible.

.07 If you file corrected returns on paper forms, use IRS forms or acceptable OCR scannable paper substitutes. Always submit Copy A to the appropriate service center. *NOTE:* Form W-2G is not required to be in OCR scannable format. Publication 1179, "Requirements for Reproducing Paper Substitutes of Forms 1096, 1099 Series, 5498, W-2G and W-3G" provides requirements and instructions. A supplement will be issued to include instructions for paper substitutes of Form 1098, Mortgage Interest Statement.

.08 For further instructions on filing information returns with IRS, refer to the 1985 "Instructions for Form 1099 Series, 1098, 5498 and 1096." If these instructions are not included in your magnetic media reporting packages, request a copy from your local IRS office.

.09 Type or machine print all information on returns filed on paper.

.10 Use the proper form. If you are in doubt, review the instructions noted in .08 above or contact your local IRS office.

.11 use only the boxes provided on the paper forms. Do not add additional boxes.

.12 Do not change the title of any box on the paper forms.

.13 Use the same name and TIN (SSN or EIN) for the filer on the Form 1096 transmittal form and all related forms that follow.

.14 A separate transmittal Form 1096 is required for each *type* of paper information return filed in the 1098, 5498 and 1099 Series. A transmittal Form W-3G is required to transmit paper Forms 1099-R and W-2G. DO NOT USE THE SAME TRANSMITTAL DOCUMENT TO FILE ORIGINAL AND CORRECTED RETURNS WHETHER ON PAPER FORMS *OR* MAGNETIC MEDIA. A transmittal Form 4804 or computer generated substitute is used to transmit magnetic media. A Form 4802 is a *continuation* form for a Form 4804. Please utilize a Form 4802 if you file on magnetic media for multiple payers and are an authorized agent for the payers.

.15 Do not staple, fold, paperclip or use rubberbands on any paper information returns filed with IRS. This could impair the OCR scanning process.

.16 Use the correct tax year's forms to file information returns with IRS (i.e., do not submit tax year 1985 returns using 1984 forms). The same is true for magnetic media filing. You must submit your returns filed on magnetic media using the revenue procedure for the tax year of the returns. Forms and revenue procedures are normally updated each year to include necessary changes.

.17 Most information returns contain a "VOID" box and a "CORRECTED" box. The "VOID" box is used only if you make an error while typing or printing the paper forms. Mark this box ONLY when you wish the return to be disregarded or passed over. The OCR scanner at the service centers *will not read* a "VOID" return; it will pass over it and go to the next form if the "VOID" box is marked. Do not confuse the "VOID" box and the "CORRECTED" box.

.18 On magnetic media files, the Payee "B" Record provides space to enter a Payer's Account Number for the Payee. This same account number may be provided on paper forms. In order to properly file corrected returns, this number will help identify the appropriate incorrect return. DO NOT ENTER A TIN (SSN OR EIN). *A PAYER'S ACCOUNT NUMBER FOR THE PAYEE MAY BE A CHECKING ACCOUNT NUMBER, SAVINGS ACCOUNT NUMBER, SERIAL NUMBER OR ANY OTHER NUMBER ASSIGNED TO THE PAYEE BY THE PAYER, WHICH WILL DISTINGUISH THE SPECIFIC ACCOUNT. THIS*

NUMBER MUST APPEAR ON THE INITIAL RETURN AND ON THE CORRECTED RETURN IN ORDER TO IDENTIFY AND PROCESS THE CORRECTION PROPERLY.

.19 REVIEW BOTH CHARTS 1 AND 2 THAT FOLLOW. The types of errors made will *normally* fall under one of the four categories listed. Next to each *type* of error made, you will find a list of instructions to tell you how to *properly* file the corrected return for *that* type of error. READ ALL OF THE INSTRUCTIONS LISTED AND FOLLOW THEM FOR THE TYPE OF ERROR MADE ON THE INITIAL RETURN. *IN SOME CASES TWO TRANSACTIONS ARE REQUIRED TO PROPERLY FILE CORRECTIONS. IF THE ORIGINAL RETURN WAS FILED AS AN AGGREGATE, YOU MUST CONSIDER THIS IN FILING THE CORRECTED RETURNS.*

CHART 1. *Guidelines for Filing Corrected Returns on Magnetic Media*

(PLEASE READ SEC. 10.01 THROUGH 10.19 OF THIS PUBLICATION BEFORE MAKING *ANY* CORRECTIONS)

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On Magnetic Media
1. Original return was filed with *NO* Payee TIN (SSN or EIN) *OR* the return was filed with an *INCORRECT* Payee TIN (SSN or EIN). THIS WILL REQUIRE TWO SEPARATE TRANSACTIONS TO MAKE THE CORRECTION PROPERLY. READ AND FOLLOW ALL INSTRUCTIONS FOR BOTH TRANSACTIONS 1 AND 2.	*TRANSACTION 1:* Identifying return submitted with *NO* TIN or an *INCORRECT* TIN A. *Form 4804 and/or 4802 (or computer generated substitute)* 1. Prepare a *new* transmittal Form 4804 (and 4802 if you file for multiple payers), or a computer generated substitute, that includes information related to this new file. (A Form 4802 is a continuation form for multiple payers and may be used if you have the authority to sign the affidavit on the Form 4804.) 2. Write, type or machine print in uppercase letters "MAGNETIC MEDIA CORRECTION" at the top of the transmittal form or computer generated substitute. 3. Provide *ALL* requested information correctly. 4. Include a hardcopy print, listing or diskette dump exhibiting a small sample of each type of *record* (A, B, C and F), which can be reviewed for accuracy and acceptability of record *format*. 5. If you are a Combined Federal/State filer, IRS will not transmit corrected returns to the state. This will be the responsibility of the filer. B. *1098, 1099 Series, 5498 and W-2G Returns* 1. Prepare a new file. 2. Use a separate Payer/Transmitter "A" Record for each *type* of return being reported. The information in the "A" Record will be the same as it was in the original submission. 3. The Payee "B" Record must contain exactly the same information as submitted previously *EXCEPT*: insert a "G" code in diskette position 6 of the "B" Record *AND* for ALL payment amounts used, enter "0" (zero). 4. Corrected returns submitted to IRS using a "G" coded "B" Record may be submitted on the same diskette as those corrections submitted *without* the "G" code; however, a separate "A" Record is required. 5. Mark the *EXTERNAL* label of the diskette "MAGNETIC MEDIA CORRECTION." 6. Submit the diskette(s), a diskette dump showing sample records coded for this type of filing, and the transmittal document to the National Computer Center. (Refer to Part A, Sec. 13 for address information.) *TRANSACTION 2:* Reporting the correct information A. *Form 4804 and/or 4802 (or computer generated substitute)* 1. If you submit records with the corrected information on a separate diskette from those that are "G" coded, prepare a *new* transmittal Form 4804 (and 4802 if you file for multiple payers), or a computer generated substitute, that includes information related to this new file.

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On Magnetic Media
	(A Form 4802 is a continuation form for multiple payers and may be used if you have the authority to sign the affidavit on the Form 4804.) 2. Write, type or machine print in uppercase letters "MAGNETIC MEDIA CORRECTION" at the top of the transmittal form or computer generated substitute. 3. Provide *ALL* requested information correctly. 4. Include a hardcopy print, listing or diskette dump exhibiting a small sample of each type of *record* (A, B, C and F), which can be reviewed for accuracy and acceptability of record *format*. 5. If you are a Combined Federal/State filer, IRS will not transmit corrected returns to the state. This will be the responsibility of the filer. B. *1098, 1099 Series, 5498 and W-2G Returns* 1. Prepare a *new* file with the correct information in *ALL* records. 2. Use a separate Payer/Transmitter "A" Record for each *type* of return being reported. 3. *Do not code the Payee "B" Record as a corrected return for this type of correction.* (Remove the "G" Code.) 4. Provide all of the correct information supplying the correct TIN (SSN or EIN). 5. Mark the *EXTERNAL* label of the diskette "MAGNETIC MEDIA CORRECTION." 6. Submit the diskette(s), a diskette dump showing sample records coded for this type of filing, and the transmittal document to the National Computer Center. (Refer to Part A, Sec. 13 for address information.)
2. Original return was filed with an incorrect payment amount(s) in the Payee "B" Record, *OR* a money amount was repoted using an incorrect Payment Amount Indicator Code in the original Payer/Transmitter "A" Record. Correct *Type Of Return* indicator was used in the "A" Record. THIS WILL REQUIRE ONLY ONE TRANSACTION TO MAKE THE CORRECTION. (NOTE: If the wrong *Type Of Return* indicator was used, see number 3 of this chart.)	A. Form 4804 and/or 4802 (or computer generated substitute) 1. Prepare a *new* transmittal Form 4804 (and 4802) if you file for multiple payers), or a computer generated substitute, that includes information related to this new file. (A Form 4802 is a continuation form for multiple payers and may be used if you have the authority to sign the affidavit on the Form 4804.) 2. Write, type or machine print in uppercase letters "MAGNETIC MEDIA CORRECTION" at the top of the transmittal form or computer generated substitute. 3. Provide *ALL* requested information correctly. 4. Include a hardcopy print, listing or diskette dump exhibiting a small sample of each type of *record* (A, B, C and F), which can be reviewed for accuracy and acceptability of record *format*. 5. If you are a Combined Federal/State filer, IRS will not transmit corrected returns to the state. This will be the responsibility of the filer. B. *1098, 1099 Series, 5498 and W-2G Returns* 1. Prepare a *new* file. 2. Use a separate Payer/Transmitter "A" Record for each *type* of return being reported. The information in the "A" Record will be the same as it was in the original submission EXCEPT, the *correct* Amount Indicators will be used. 3. The Payee "B" Record must contain exactly the same information as submitted previously *EXCEPT:* insert a

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On Magnetic Media
	"G" code in diskette position 6 of the "B" Record *AND* report the correct payment amounts as they should have been reported on the initial return. 4. Corrected returns submitted to IRS using a "G" coded "B" Record may be submitted on the same diskette as those corrections submitted without the "G" code; however, a separate "A" Record is required. 5. Mark the *EXTERNAL* label of the diskette "MAGNETIC MEDIA CORRECTION." 6. Submit the diskette(s), a diskette dump showing sample records coded for this type of filing, and the transmittal document to the National Computer Center. (Refer to part A, Sec. 13 for address information.)
3. Original return was filed using the WRONG *Type of Return* indicator in the Payer/Transmitter "A" Record. (For example, a return was coded using the *Type of Return* indicator for 1099-DIV and it should have been coded 1099-INT.) THIS WILL REQUIRE TWO SEPARATE TRANSACTIONS TO MAKE THE CORRECTION PROPERLY. READ AND FOLLOW *ALL* INSTRUCTIONS FOR *BOTH* TRANSACTIONS 1 AND 2.	*TRANSACTION 1:* Identifying return submitted with an incorrect Type Of Return indicator A. *Form 4804 and/or 4802 (or computer generated substitute)* 1. Prepare a *new* transmittal Form 4804 (and 4802 if you file for multiple payers), or a computer generated substitute, that includes information related to this new file. (A Form 4802 is a continuation form for multiple payers and may be used if you have the authority to sign the affidavit on the Form 4804.) 2. Write, type or machine print in uppercase letters "MAGNETIC MEDIA CORRECTION" at the top of the transmittal form or computer generated substitute. 3. Provide *ALL* requested information correctly. 4. Include a hardcopy print, listing or diskette dump exhibiting a small sample of each type of *record* (A, B, C and F), which can be reviewed for accuracy and acceptability of record *format*. 5. If you are a Combined Federal/State filter, IRS will not transmit corrected returns to the state. This will be the responsibility of the filer. B. *1098, 1099 Series, 5498 and W-2G Returns* 1. Use a separate Payer/Transmitter "A" Record for each *type* of return being reported. The information in the "A" Record will be exactly the same as it was in the original submission using the same incorrect type of return indicator. 2. The corrected Payee "B" Record must contain the same information as submitted previously *EXCEPT:* insert a "G" code in diskette position 6 of the "B" Record and for *ALL* payment amounts *used,* enter "0" (zero). 3. Corrected returns submitted to IRS using a "G" coded "B" Record may be submitted on the same diskette as those corrections submitted without the "G" code; however, a separate "A" Record is required. 4. Mark the *EXTERNAL* label of the diskette "MAGNETIC MEDIA CORRECTION." 5. Submit the diskette(s), a diskette dump showing sample records coded for this type of filing, and the transmittal document to the National Computer Center. (Refer to part A, Sec. 13 for address information.) *TRANSACTION 2:* Reporting the correct information A. *Form 4804 and/or 4802 (or computer generated substitute)* 1. If you submit records with the corrected information on

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On Magnetic Media
	a separate diskette from those that are "G" coded, prepare a *new* transmittal Form 4804 (and 4802 if you file for multiple payers), or a computer generated substitute, that includes information related to this new file. (A Form 4802 is a continuation form for multiple payers and may be used if you have the authority to sign the affidavit on the Form 4804.) 2. Write, type or machine print in uppercase letters "MAGNETIC MEDIA CORRECTION" at the top of the transmittal form or computer generated substitute. 3. Provide *ALL* requested information correctly. 4. Include a hardcopy print, listing or diskette dump exhibiting a small sample of each type of *record* (A, B, C and F), which can be reviewed for accuracy and acceptability of record *format*. 5. If you are a Combined Federal/State filer, IRS will not transmit corrected returns to the state. This will be the responsibility of the filer. B. *1098, 1099 Series, 5498 and W-2G Returns* 1. Prepare a *new* file with the correct information in *ALL* records. 2. Use a separate Payer/Transmitter "A" Record for each *type* of return being reported and use the correct Type Of Return indicator. 3. *Do not code the Payee "B" Record as a corrected return for this type of correction.* (Remove the "G" Code.) 4. Provide all of the correct information. 5. Mark the *EXTERNAL* label of the diskette "MAGNETIC MEDIA CORRECTION." 6. Submit the diskette(s), a diskette dump showing sample records coded for this type of filing, and the transmittal document to the National Computer Center. (Refer to part A, Sec. 13 for address information.)

CHART 2. *Guidelines for Filing Corrected Returns On Paper Forms*

(PLEASE READ SEC. 10.01 THROUGH 10.19 OF THIS PUBLICATION BEFORE MAKING *ANY* CORRECTIONS)

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On PAPER forms
1. Original return was filed with *NO* Payee TIN (SSN or EIN), *OR* the return was filed with an *INCORRECT* Payee TIN. THIS WILL REQUIRE TWO SEPARATE TRANSACTIONS TO MAKE THE CORRECTION PROPERLY. READ AND FOLLOW *ALL* INSTRUCTIONS FOR BOTH TRANSACTIONS 1 *AND* 2.	*TRANSACTION 1:* Identifying return submitted with *NO* TIN or an *INCORRECT* TIN A. *Form 1096 or W-3G* 1. Prepare a *new* transmittal Form 1096 or W-3G depending on the *type* of return being filed. 2. *Mark over the "X" in the "CORRECTED" box at the top of the form.* 3. Provide *all* requested information correctly. 4. Type or machine print in upper case letters "MAGNETIC MEDIA CORRECTION" in the blank space below the instructions. 5. Do *NOT* staple this transmittal form to the related returns. 6. Use a separate trasmittal form for each *type* of return.

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On PAPER forms
	7. A transmittal Form 1096 or W-3G *MUST* be present. (Refer to .14 of this section for clarification.)
	B. *Form 1098, 1099 Series, 5498 or W-2G*
	1. Prepare a *new* information return on the proper *type* of form.
	2. *Mark over the "X" in the "CORRECTED" box at the top of the form(s).*
	3. Enter the Payer, Recipient and Account Number information (if any) *exactly* as it appeared on the original incorrect return filed with *NO* TIN or *INCORRECT* TIN: HOWEVER, enter "0" (zero) for *all* money amounts.
	4. File the transmittal document and Copy A of the returns with the appropriate service center.
	5. Do *NOT* cut the forms that are three to a page.
	6. Do *NOT* staple, paperclip or use rubberbands on the forms.
	7. Use a separate transmittal Form 1096 or Form W-3G (depending on the *type* of return) to transmit the "CORRECTED" return(s).
	8. *Do NOT include copies of the original return that was filed incorrectly.*
	TRANSACTION 2: Reporting correct information
	A. *Form 1096 or W-3G:*
	1. Prepare a *new* transmittal Form 1096 or W-3G depending on the *type* of return being filed.
	2. *Do NOT mark over the "X" in the "CORRECTED" box at the top of the form for THIS type of correction.*
	3. Provide *all* requested information correctly.
	4. Type or machine print in upper case letters "MAGNETIC MEDIA CORRECTION" in the blank space below the instructions.
	5. Do *NOT* staple this transmittal form to the related returns.
	6. Use a separate transmittal form for each *type* of return.
	7. A transmittal Form 1096 or W-3G *MUST* be present. (Refer to .14 of this section for clarification.)
	B. *Form 1098, 1099 Series, 5498 or W-2G:*
	1. Prepare a *new* information return on the proper *type* of form.
	2. *Do NOT mark over the "X" in the "CORRECTED" box at the top of the form(s) for this type of correction.* Submit the *new* returns as though they were originals.
	3. Include *all* of the correct information supplying the TIN (SSN or EIN).
	4. File the transmittal document and Copy A of the returns with the appropriate service center.
	5. Do *NOT* cut the forms that are three to a page.
	6. Do *NOT* staple, paperclip or use rubberbands on the forms.
	7. Use a separate transmittal Form 1096 or W-3G (depending on the *type* of return) to transmit the corrected returns. *You MUST NOT use the same transmittal used in Transaction 1.*
	8. *Do NOT include copies of the original return that was filed incorrectly.*
2. Original return was filed with incorrect payment amount(s) in the Payee "B" Record, OR a money	A. *Form 1096 or W-3G*
	1. Prepare a *new* transmittal Form 1096 or W-3G de-

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On PAPER forms
amount was reported using an incorrect payment Amount Inidcator Code in the original Payer/ Transmitter "A" Record. Correct *Type* of *Return* indicator was used in the "A" Record. THIS WILL REQUIRE ONLY ONE TRANSACTION TO MAKE THE CORRECTION. (If the WRONG *Type* of *Return* indicator was used, see number 3 of this chart.)	pending on the *type* of return being filed. 2. *Mark over the "X" in the "CORRECTED" box at the top of the form.* 3. Provide *all* requested information correctly. 4. Type or machine print in upper case letters "MAGNETIC MEDIA CORRECTION" in the blank space below the instructions. 5. Do *NOT* staple this transmittal form to the related returns. 6. Use a separate transmittal form for each *type* of return. 7. A transmittal Form 1096 or W-3G *MUST* be present. (Refer to .14 of this section for clarification.) B. *Form 1098, 1099 Series, 5498 or W-2G* 1. Prepare a *new* information return on the proper *type* of form. 2. *Mark over the "X" in the "CORRECTED" box at the top of the form(s).* 3. Enter the Payer, Recipient and Account Number information *exactly* as it appeared on the original incorrect return; HOWEVER, *enter all correct money amounts in the correct boxes as they should have appeared on the original return.* 4. File the transmittal document and Copy A of the returns with the appropriate service center. 5. Do *NOT* cut the forms that are three to a page. 6. Do *NOT* staple, paperclip or use rubberbands on the forms. 7. Use a separate transmittal Form 1096 or W-3G (depending on the *type* of return) to transmit the corrected returns. 8. *Do NOT include copies of the original return that was filed incorrectly.*
3. Original return was filed using the WRONG *Type of Return* indicator in the Payer/Transmitter "A" Record. (For example, a return was coded using the *Type of Return* indicator for 1099-DIV and it should have been coded as 1099-INT.) THIS WILL REQUIRE TWO SEPARATE TRANSACTIONS TO MAKE THE CORRECTION PROPERLY. READ AND FOLLOW *ALL* INSTRUCTIONS FOR BOTH TRANSACTIONS 1 AND 2.	*Transaction 1:* Identifying return submitted with an incorrect Type Of Return indicator A. *Form 1096 or W-3G* 1. Prepare a *new* transmittal Form 1096 or W-3G depending on the *type* of return being filed. 2. *Mark over the "X" in the "CORRECTED" box at the top of the form.* 3. Provide *all* requested information correctly. 4. Type or machine print in upper case letters "MAGNETIC MEDIA CORRECTION" in the blank space below the instructions. 5. Do *NOT* staple this transmittal form to the related returns. 6. Use a separate transmittal form for each *type* of return. 7. A transmittal Form 1096 or W-3G *MUST* be present. (Refer to .14 of this section for clarification.) B. *Form 1098, 1099 Series, 5498 or W-2G* 1. *Prepare a new information return on the same type of form that was used initially.* 2. *Mark over the "X" in the "CORRECTED" box at the top of the form(s).* 3. Enter the Payer, Recipient and Account Number information *exactly* as it appeared on the original incorrect return; HOWEVER, enter "0" (zero) for *all* money amounts.

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On PAPER forms
	4. File the transmittal document and Copy A of the returns with the appropriate service center. 5. Do *NOT* cut the forms that are three to a page. 6. Do *NOT* staple, paperclip or use rubberbands on the forms. 7. Use a separate transmittal Form 1096 or W-3G (depending on the *type* of return) to transmit the "CORRECTED" return(s). 8. *DO NOT include copies of the original return that was filed incorrectly.* *TRANSACTION 2:* Reporting correct information on the correct *type* of return A. *Form 1096 or W-3G* 1. Prepare a *new* transmittal Form 1096 or W-3G depending on the *type* of return being filed. 2. *Do NOT mark over the "X" in the "CORRECTED" box at the top of the form for THIS type of correction.* 3. Provide *all* requested information correctly. 4. Type or machine print in upper case letters "MAGNETIC MEDIA CORRECTION" in the blank space below the instructions. 5. Do *NOT* staple this transmittal form to the related returns. 6. Use a separate transmittal form for each *type* of return. 7. A transmittal Form 1096 or W-3G *MUST* be present. (Refer to .14 of this section for clarification.) B. *Form 1098, 1099 Series, 5498 or W-2G* 1. Prepare a *new* information return utilizing the proper *type* of form. 2. *Do NOT mark over the "X" in the "CORRECTED" box at the top of the form(s) for this type of correction.* Submit the new return(s) as though they were originals. 3. Include *all* of the correct information. 4. File the transmittal document and Copy A of the returns with the appropriate service center. 5. Do *NOT* cut the forms that are three to a page. 6. Do *NOT* staple, paperclip or use rubberbands on the forms. 7. Use a separate transmittal Form 1096 or W-3G (depending on the *type* of return) to transmit the corrected returns. You *MUST NOT* use the same transmittal used in Transaction 1. 8. *Do NOT include copies of the original return that was filed incorrectly.*

Sec. 11. TAXPAYER IDENTIFICATION NUMBERS

.01 Under section 6109 of the Internal Revenue Code, recipients of all reportable payments on information returns are required to furnish Taxpayer Identification Numbers (TINs) to the payer. The number must be furnished to the payer whether or not the payee is required to file a tax return or is covered by social security. Refer to Sec. 15 for a definition of Taxpayer Identification Number (TIN).

.02 The recipient's TIN is used to associate and verify amounts reported to IRS with corresponding amounts on tax returns. Therefore, it is particularly important that correct social security and employer identification numbers for payees be provided on magnetic media or paper forms submitted to IRS. *DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROES.*

.03 Under section 6676 of the Internal Revenue Code, a $50 penalty applies for each failure to furnish a TIN to another person who is required to file an information return, and for each failure to include a TIN on an information return. The penalty for payments other than interest or dividends applies unless the failures were due to reason-

able cause and not willful neglect.

.04 With respect to all payers of interest and dividends, section 6676 of the Internal Revenue Code provides that the payer must self-assess a *$50 penalty* for each failure to include a payee's TIN or each inclusion of an incorrect TIN on an information return, unless the payer can demonstrate that the payer met the due diligence requirements in attempting to acquire correct TINs for payees. Use form 8210, Self-Assessed Penalties Return.

.05 For any reportable payment, if the payee fails to provide a TIN to the payer or if IRS notifies you that the TIN provided is incorrect, then backup withholding must be instituted for that payee. In the case of notice of an incorrect TIN from IRS, the payer must begin withholding on the 31st day after the notice is received. If the payer receives another TIN in the manner required from the payee within 30 days of notice from IRS, no withholding is required.

.06 The TIN to be furnished to IRS depends primarily upon the manner in which the account is maintained or set up on the payer's record. The TIN to be provided must be that of the owner of the account. If the account is recorded in more than one name, furnish the TIN and name of one of the owners of the account. The TIN provided must be associated with the name of the payee provided in the first name line of the Payee "B" Record. For individuals, including sole proprietors, the payee TIN is the payee's social security number. For other entities, the payee TIN is the payee's employer identification number.

.07 Sole proprietors who are payers should show their employer identification number in the Payer/Transmitter "A" Record. However, sole proprietors who are not otherwise required to have an employer identification number should use their social security number.

.08 Sole proprietors' social security numbers must be used in the Payee "B" Record.

.09 The charts below will help you determine the number to be furnished to IRS for recipients of reportable payments (payees).

CHART 1. Guidelines for Social Security Numbers

For this type of account:	In the Taxpayer Identification Number field of the Payee "B" Record, enter the SSN of—	In the First Payee Name Line of the Payee "B" Record, enter the name of—
1. An individual's account.	The individual.	The individual.
2. A joint account (Two or more individuals, husband and wife).	The actual owner of the account. (If more than one owner, the first individual on the account.)	The individual whose SSN is entered.
3. Account in the name of a guardian or committee for a designated ward, minor, or incompetent person.	The ward, minor, or incompetent person.	The individual whose SSN is entered.
4. Custodian account of a minor (Uniform Gift to Minors Act).	The minor.	The minor.
5. The usual revocable savings trust account (grantor is also trustee).	The grantor-trustee.	The grantor-trustee.
6. A so-called trust account that is not a legal or valid trust under state law.	The actual owner.	The actual owner.
7. A sole proprietorship.	The owner.	The owner.

CHART 2. Guidelines for Employer Identification Numbers

For this account type—	In the Taxpayer Identification Number field of the Payee "B" Record, enter the EIN of—	In the First Payee Name Line of the Payee "B" Record, enter the name of—
1. A valid trust, estate, or pension trust.	Legal entity.[1]	The legal trust, estate, or pension trust.
2. A corporate account.	The corporation.	The corporation.
3. An association, club, religious, charitable, educational or other tax-exempt organization.	The organization.	The organization.
4. A partnership account held in the name of the business.	The partnership.	The partnership.
5. A broker or registered nominee/ middleman.	The broker or nominee/ middleman.	The broker or nominee/middleman.
6. Account with the Department of Agriculture in the name of a public entity, such as state or local government, school district or prison, that receives agriculture program payments.	The public entity.	The public entity.

[1]Do not furnish the identification number of the personal representative or trustee unless the name of the representative or trustee is used in the account title.

SEC. 12. EFFECT ON PAPER RETURNS

.01 Diskette reporting of the information returns listed in Part A, Sec. 1 applies only to the original (Copy A).

.02 For payments of dividends or interest (reported on Forms 1099-DIV, 1099-PATR, 1099-INT or 1099-OID), the payer is required to furnish an official Form 1099 to a payee either in a separate mailing by First-Class mail or in person. These forms may not be combined or mailed with other information furnished to the recipient except Form W-9 or other Form 1099 statements. The payer may use substitute Forms 1099 if they are substantially similar to the official forms and if the payer complies with all revenue procedures relating to substitute Forms 1099 in effect at the time (see Publication 1179, Requirements for Reproducing Paper Substitutes of Forms 1096, 1099 Series, 5498, W-2G and W-3G). A supplement will be issued to include instructions for substitutes of Form 1098, Mortgage Interest Statement. Copy B (For Recipient) of the substitute forms must contain the statement "This is important tax information and is being furnished to IRS. If you are required to file a return, a negligence penalty will be imposed on you if this income is taxable and IRS determines that it has not been reported."

.03 Statements to recipients for Forms 1098, 1099-A, 1099-B, 1099-G, 1099-MISC (except for substitute payments in lieu of dividends and tax-exempt interest), 1099-R, 5498 or W-2G need not be a copy of the paper form filed with IRS. It is important that income items be properly classified for Federal tax purposes on the statement the payer gives to recipients. The message "This information is being furnished to IRS" must appear on the statements. The payer may combine the statements with other reports or financial or commercial notices, or expand them to include other information of interest to the recipient. Also, be sure that all copies of the forms are legible and provide the recipient with applicable instructions that appear on the back of the recipient's copy of the official IRS form so that the information may properly be used by the recipient in meeting his or her tax obligations.

.04 If a portion of the returns is reported on diskette and the remainder is reported on paper forms, those returns not submitted on diskette must be filed on official forms or on acceptable paper substitutes meeting specifications in Publication 1179, Requirements for Reproducing Paper Substitutes of Forms 1096, 1099 Series, 5498, W-2G and W-3G. A supplement will be issued to include instructions for substitutes of Form 1098, Mortgage Interest Statement.

SEC. 13. MAGNETIC MEDIA COORDINATOR CONTACTS

.01 On January 1, 1985, the National Computer Center assumed responsibility for the *magnetic media* processing previously handled by the Philadelphia, Kansas City, and Austin Service Centers. Beginning January 1, 1986, magnetic media processing for *all* service centers will be centralized at the National Computer Center. *On or after January 1, 1986, please direct all requests for magnetic media related publications, information, undue hardship waivers, or forms to the following address:*

Magnetic Media Reporting
Internal Revenue Service
National Computer Center
Post Office Box 1359
Martinsburg, WV 25401-1359

Hours of operation at this address will be 8:30 AM until 8:00 PM Eastern Time Zone.

Prior to January 1, 1986, requests for *magnetic media* related publications, forms, undue hardship waivers, or information will still be handled by the following service centers only:

(a) Internal Revenue Service
Andover Service Center
Post Office Box 311
Stop 481
Andover, MA 01810

(b) Internal Revenue Service
Brookhaven Service Center
Post Office Box 486
Holtsville, NY 11742

(c) Internal Revenue Service
Atlanta Service Center
Post Office Box 47-421
Doraville, GA 30362

(d) Internal Revenue Service
Memphis Service Center
Post Office Box 1900
Memphis, TN 38101

(e) Internal Revenue Service
Cincinnati Service Center
Post Office Box 267
201 West Second Street
Covington, KY 41019

(f) Internal Revenue Service
Ogden Service Center
Post Office Box 9941
1160 West 12th Street
Ogden, UT 84409

(g) Internal Revenue Service
Fresno Service Center
Post Office Box 12866
Fresno, CA 93779

.02 The National Computer Center will process returns filed on magnetic media only. *All* information returns filed on paper forms should be submitted to the appropriate service center, not the National Computer Center. Organizations who file their information returns on magnetic media but who submit their corrected returns on paper forms with the Philadelphia, Kansas City and Austin Service Centers, please use the following addresses for returns filed on paper:

(a) Internal Revenue Service
Philadelphia Service Center
Post Office Box 245
Bensalem, PA 19020

(b) Internal Revenue Service
Kansas City Serice Center
2306 East Bannister Road
Stop 36
Kansas City, MO 64131

(c) Internal Revenue Service
Austin Service Center
Post Office Box 934
Austin, TX 78767

SEC. 14. COMBINED FEDERAL/STATE FILING

.01 The Combined Federal/State Program was established to simplify information returns filing for the taxpayer. IRS will accept, upon prior approval, diskette files containing state reporting information only for those states listed in Table 1 in this section. *FORMS 1098, 1099-A, 1099-B AND W-2G CANNOT BE FILED UNDER THE COMBINED FEDERAL/STATE FILING PROGRAM.*

.02 To request approval to participate in the Combined Federal/State Program, a "test" file, *coded for this program*, must be submitted between September and December using the revenue procedure that will be used for the actual data files. Refer to Part A, Sec. 13 for address information. See Part A, Sec. 5.04 for general guidelines on submission of "test" files. Each record, both in the "test" file and actual data file, must be 360 positions in length, and the file must conform *exactly* to the revenue procedure for the tax year of the *actual* data. Combined Federal/State records must be coded using each state's dollar criteria from Table 2 of this Section for each *type* of return.

If the "test" diskette is determined to be acceptable, IRS will return it to the filer with a letter of approval to participate in the Combined Federal/State Program. Form 6847, Consent For Internal Revenue Service to Release Tax Information, will be included with the letter of approval. You *must* complete Form 6847, include your 5 character Transmitter Control Code on the form, and return it to IRS before IRS will release tax information to any of the participating states. Do not submit *actual* data records coded for the Combined Federal/State Program without prior approval from IRS. The first time you submit actual data files coded for this program, include the signed Form 6847.

.03 States that participate in this program and the valid state code assigned to each are listed in Table 1 of this Section. If the state that you wish information released to does *not* participate in the program, do *not* code your records for that state. If the state participates, if you have received prior approval, and if all other conditions are met, IRS will forward the tax information to the participating state at no charge to the filer.

.04 *IF CORRECTIONS MUST BE MADE, IRS WILL NOT TRANSMIT CORRECTED RETURNS TO THE STATES. THIS WILL BE THE RESPONSIBILITY OF THE FILER.*

.05 IRS will make no attempt to process files with any deviations. Approval to participate in the Combined Federal/State Program will be revoked if any files are submitted that do not *totally* conform.

.06 IRS is acting as a forwarding agent *ONLY*. Some participating states require separate notification that you are filing in this manner. It is your responsibility to contact the appropriate states for further information.

.07 The appropriate state code should be entered for those documents which meet that state's filing requirements. *It is the filer's responsibility* to determine the state code to be used and to obtain the filing requirements from the appropriate state(s).

.08 If you meet all of the requirements for this program, you *must* provide the state totals from the "K" record on a separate Form 4804 Transmittal of Information Returns on Magnetic Media (or Form 4802, Multiple Payer Transmittal For Magnetic Media Reporting) or computer generated substitute for each state, *or* you must include a listing which identifies each state and the "K" record totals for each.

.09 If you have met *ALL* of the above conditions:

(a) You must submit all records using two 128 position sectors which indicate the appropriate coding related to this program.

(b) The "C" record *must* be followed by a "K" Record for each state. The "K" record indicates the number of payees (different TINs) being reported to each particular state.

(c) Payment amount totals and the valid participating state code must

included in the state totals "K" Record. Refer to Part B, Sec. 16, for a description of the "K" Record.

(d) The "K" record is followed by an end of transmission "F" Record (if this is the last record of the entire file).

.10 Only those states listed in Table 1 below will receive information from IRS. *It is the filter's responsibility to file information returns with states that do not participate in this program.*

TABLE 1. PARTICIPATING STATES AND THEIR CODES

State	Code	*State*	*Code*	*State*	*Code*
Alabama	01	Iowa	19	New York	36
Arizona	04	Kansas	20	North Carolina	37
Arkansas	05	Maine	23	North Dakota	38
California	06	Massachusetts	25	Oregon	41
Delaware	10	Minnesota	27	South Carolina	45
District of Colubmia	11	Mississippi	28	Tennessee	47
Georgia	13	Missouri	29	Wisconsin	55
Hawaii	15	Montana	30		
Idaho	16	New Jersey	34		
Indiana	18	New Mexico	35		

.11 To simplify filing, several of the participating states have provided lists of their information return reporting requirements (see Table 2). This cumulative list is for information purposes only and represents dollar criteria. For complete information on state filing requirements, contact the appropriate state tax agencies.

TABLE 2. DOLLAR CRITERIA

STATE	1099-R	1099-DIV	1099-INT	1099-MISC	1099 PATR	1099-G	1099-OID	5498
Alabama	1500	1500	1500	1500	1500	NR	1500	NR
Arizona[a]	300	300	300	300	300	300	300	NR
Arkansas	2500	100	100	2500	2500	2500	2500	[i]
District of Columbia[b]	600	600	600	600	600	600	600	NR
Hawaii	600	10	10[c]	600	10	all	10	[i]
Idaho	600	10	10	600	10	10	10	[i]
Iowa	1000	100	1000	1000	1000	1000	1000	NR
Minnesota	600	10	10[d]	600[e]	10	10	10	NR
Missouri	NR	NR	NR	1200[f]	NR	NR	NR	NR
Montana	600	10	10	600	10	10	10	[i]
New Jersey	1000	1000	1000	1000	1000	1000	1000	NR
New York	600	NR	600	600[g]	NR	600	NR	NR
North Carolina	100	100	100	600	100	100	100	[i]
Oregon	600[2h]	10	10	600	10	10	10	NR
Tennessee	NR	25	25	NR	NR	NR	NR	NR
Wisconsin	500	100	100	100	100	NR	NR	NR

NR—No filing requirement.

Footnotes:

[a] These requirements apply to individuals and business entities.

[b] Amounts are for aggregates of several types of income from the same payroll.

[c] State regulation changing filing requirement from $600 to $10 is pending.

[d] $10.01 for Savings and Loan Associations and Credit Unions.

[e] $600.01 for Rents and Royalties.

[f] Aggregate both types of returns. The state would prefer those returns filed with respect to non-Missouri residents to be sent directly to the state agency.

[g] Aggregate of several types of income.

[h] Return required for state of Oregon residents only.

[i] Same as federal requirement for this type of return.

*NOTE: Filing requirements for any state not shown on the above chart are the same as the Federal requirement.

SEC. 15. DEFINITIONS OF TERMS

Element	Description
b	Denotes a blank position. Enter blank(s) when this symbol is used (do *2not* enter the letter "b). This appears in numerous areas throughout the record descriptions.
Coding Range	Indicates the allowable codes for a particular type of statement.
EIN	Employer Identification Number that has been assigned by IRS to the reporting entity.
Excess Golden Parachute Payment	Parachute payments (also called "golden parachutes") are certain payments in the nature of compensation which corporations make to key individuals, often in excess of their usual compensation, in the event that ownership or control of the corporation changes.
File	For purposes of this procedure, a file consists of all diskette records submitted by a Payer or Transmitter.
Payee	Person(s) or organization(s) receiving payments from the Payer, or for whom an information return must be filed.
Payer	Person or organization, including paying agent, making payments or the person liable for filing an information return. The Payer will be held responsible for the completeness, accuracy and timely submission of diskette files.
Special Character	Any character that is not a numeral, a letter or a blank
SSA	Social Security Administration.
SSN	Social Security Number.
Taxpayer Identification Number (TIN)	May be either an EIN or SSN.
Transfer Agent (Paying Agent)	The transfer agent or paying agent is the entity who has been contracted or authorized by the payer to perform the services of paying and reporting backup withholding (Form 941). The payer must submit to IRS a Form 2678, Employer Appointment of Agent under Section 3504, which notifies IRS of the transfer agent relationship.
Transmitter	Person or organization preparing diskette file(s). May be Payer or agent of payer.
Transmitter Control Code	A *five* character number assigned by IRS to the transmitter prior to actual filing on magnetic media. This number is inserted in the "A" Record of your files and *must* be present before the file can be processed. An application Form 4419 must be filed with IRS to receive this number. See Part A, Sec. 5. (Abbreviation for this term is TCC.)

SEC. 16. U.S. POSTAL SERVICE STATE ABBREVIATIONS

You *MUST* use the following U.S. Postal Service State abbreviations when developing the state code portion of Name Line fields. (This table provides state abbreviations only and does not represent those states participating in the Combined Federal/State Program. For a list of states that participate in the Combined Federal/State Program, refer to Sec. 14.10.)

State	*Code*	*State*	*Code*	*State*	*Code*
Alabama	AL	Kentucky	KY	North Dakota	ND
Alaska	AK	Louisiana	LA	Ohio	OH
Arizona	AZ	Maine	ME	Oklahoma	OK
Arkansas	AR	Maryland	MD	Oregon	OR
California	CA	Massachusetts	MA	Pennsylvania	PA
Colorado	CO	Michigan	MI	Rhode Island	RI
Connecticut	CT	Minnesota	MN	South Carolina	SC
Delaware	DE	Mississippi	MS	South Dakota	SD
District of Columbia	DC	Missouri	MO	Tennessee	TN
Florida	FL	Montana	MT	Texas	TX
Georgia	GA	Nebraska	NE	Utah	UT
Hawaii	HI	Nevada	NV	Vermont	VT
Idaho	ID	New Hampshire	NH	Virginia	VA
Illinois	IL	New Jersey	NJ	Washington	WA
Indiana	IN	New Mexico	NM	West Virginia	WV
Iowa	IA	New York	NY	Wisconsin	WI
Kansas	KS	North Carolina	NC	Wyoming	WY

PART B. DISKETTE SPECIFICATION

SECTION 1. GENERAL

.01 The specifications contained in this part of the revenue procedure prescribe the required format and contents of the records to be included in the diskette file. These specifications must be adhered to unless deviations have been specifically granted by IRS in writing.

.02 To be compatible, a diskette file must meet the following specifications in total:

(a) 8 inches in diameter.

(b) recorded in basic data exchange mode.

(c) contain 77 tracks of which:

(1) Track 0 is the index track

(2) Tracks 1 through 73 are data tracks

(3) Track 74 is unused

(4) Tracks 75 and 76 are alternate data tracks.

(d) each Track must contain 26 sectors.

(e) each Sector must contain 128 bytes.

(f) data must be recorded on only one side of the diskette.

(g) IRS can only process single sided, single density, soft sectored diskettes; double sided, double density, hard sectored diskettes are *NOT* acceptable and will be returned if submitted.

(h) an IBM 3741 compatible diskette would meet the above specifications. Other types of diskettes would have to be tested to determine acceptability.

.03 Payers who can substantially conform to these specifications, but who require some minor deviations, MUST contact the Magnetic Media Coordinator at the National Computer Center or the service centers. Under no circumstances may diskettes deviating from the specifications in this revenue procedure be submitted without prior written approval from IRS. If you file under the Combined Federal/State program, your files must conform totally to this revenue procedure.

.04 An external label must appear on each diskette submitted for processing. The following information is needed:

(a) The trasmitter's name.

(b) The five character Transmitter Control Code.

(c) The type of computer equipment that the data was prepared on.

(d) The type of drive utilized.

(e) The tax year of the data (e.g., 1985).

(f) Document types (e.g., 1099 INT).

(g) The total number of payers (from the "F" record).

(h) The total number of payees (from the "C" record).

(i) The total number of diskettes in the file.

(j) A diskette number assigned by the transmitter.

(k) The sequence of each diskette (e.g., 001 of 008).

This information will assist IRS in processing the file or in locating a file, should the transmitter request that it be returned due to errors. IRS advises that special shipping containers not be used for transmitting data since it cannot be guaranteed that they will be returned.

SEC. 2. DISKETTE HEADER LABEL

.01 The header label on the diskette must be formatted as shown in the following layout:

HDR1	Blank	Data Set Name (For Transmitter's Use)	Blank	Sector Length	Blank	Beginning of Extent (BOE)
(a)	(b)	(c)	(b)	(d)	(b)	(e)
1–4	5	6–13	14–22	23–27	28	29–33
Blank	End of Extent (EOE)	Blank	Bypass Data Set	Data Set Accessibility	Write Protect	Blank
(b)	(f)	(b)	(g)	(h)	(i)	(b)
34	35–39	40	41	42	43	44
Multi-Volume	Blank	Expiration Date YYMMDD	Verify Mark	Blank	End of Data	
(j)	(b)	(k)	(l)	(b)	(m)	
45	46–66	67–72	73	74	75–79	

(a) Header 1—Positions 1 through 4; enter HDR1.

(b) Unused—Any field marked blank is unused and should contain only blanks.

(c) Data Set Name—Positions 6 through 13; you can use this field to identify your data set.

(d) Sector Length—Positions 23 through 27; enter the sector length 128, right justify and fill positions 23 and 24 with zeroes.

(e) Beginning of Extent (BOE)—Positions 29 through 33; enter the five-digit address designated for the first record of this data set. For example, if the first record is to go in track 01, sector 02, enter 01002, or xx0yy where xx is the track number and yy is the sector number.

(f) End of Extent (EOE)—Positions 35 through 39; enter the five-digit address of the last position of the disk reserved for this data set. For example, to reserve the entire disk for a data set, enter 73026.
(g) Bypass Data Set—Position 41; enter B if you want to bypass this data set; otherwise, enter a blank.
(h) Data Set Accessibility—Position 42, enter a blank, any other character in this field causes the equipment to refuse the disk.
(i) Write Protect—Position 43; this field defines the protected status of the associated data set. P = read only; blank = read/write. With P in this position, you can only select the Update (U) mode.
(j) Multi-Volume—Position 45; this field indicates whether a complete data set is on a disk. Blank = data set complete; C = data set continued on another disk; L = last disk of a multi-disk data set.
(k) Expiration Date—Positions 67 through 72; *may* be used to contain the date that the data set expires. The format is YYMMDD where YY is the year, MM is the month and DD is the day.
(l) Verify Mark—Position 73; this single character field shows if the data set is verified. If it is, enter V, if it is not verified, enter a blank.
(m) End of Data (EOD)—Positions 75–79; enter the track number in positions 75 and 76, enter a "0" (zero) in position 77 and enter the sector number in positions 78 and 79.

SEC. 3. PAYER/TRANSMITTER "A" RECORD

.01 Identifies the payer and transmitter of the diskette and provides parameters for the succeeding Payee "B" Records. IRS computer programs rely on the absolute relationship between the parameters and data fields in the "A" Record and the data fields in the "B" Records to which they apply.

.02 The number of "A" Records appearing on a diskette will depend on the number of payers and the different types of returns being reported. After the header label on the diskette, the first record appearing in the file must be an "A" Record. For diskette filing, the *actual* record lengths for the "A" and "B" records must agree with whatever is entered in diskette positions 29–31 and 32–34 of the "A" Record. A transmitter may include Payee "B" Records for more than one payer on a diskette; however, each GROUP of Payee "B" Records must be preceded by an "A" Record. A single diskette may also contain different types of returns, but the returns MUST not be intermingled. A separate "A" Record is required for each type of return being reported. An "A" Record may be blocked with "B" Records; however, the initial record on a *file* must be an "A" Record. The IRS will accept an "A" Record after a "C" Record.

RECORD NAME: PAYER/TRANSMITTER "A" RECORD

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1			
1	Record Sequence	1	REQUIRED. Must be a "1". It is used to sequence the sectors making up a Service Record.
2	Record Type	1	REQUIRED. Enter "A".
3	Payment Year	1	REQUIRED. Must be the right most digit of the year for which information is being reported (e.g., if payments were made in 1985, enter "5"). Must be incremented each year.
4-6	Diskette Sequence Number	3	REQUIRED. Sequence number assigned by the Transmitter to each diskette starting with 001. (Blanks are acceptable or all zeroes.)
7-15	Payer's Federal EIN	9	REQUIRED. Must be the *valid* 9-digit number assigned to the payer by IRS. DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROES.
16	Blank	1	REQUIRED. Enter blank.

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
17	Combined Federal/State Filer	1	REQUIRED. Enter the appropriate code from the table below. *Prior approval* is required. A Consent Form 6847 *must* be submitted to IRS before tax information will be released to the states. Refer to Part A, Sec. 14.11 for money criteria. Not all states participate in this Program. If the Payer/Transmitter is not participating in the Combined Federal/State Program, enter blanks. (Refer to Part A, Sec. 14 for the requirements that *must* be met *prior* to actual participation in this program.) Forms 1098, 1099-A, 1099-B and W-2G cannot be filed on this Program. *Code* — Meaning 1 — Participating in the Combined Federal/State Filing Program blank — Not participating
18	Type of Return	1	REQUIRED. Enter appropriate code from table below: *Type of Return* — *Code* 1098 — 3 1099-A — 4 1099-B — B 1099-DIV — 1 1099-G — F 1099-INT — 6 1099-MISC — A 1099-OID — D 1099-PATR — 7 1099-R — 9 5498 — L W-2G — W
19-27	Amount Indicators	9	REQUIRED. In most cases, the boxes or Amount Indicators on paper information returns correspond with the Amount Codes used to file on magnetic media; however, should you notice discrepancies, please disregard them and program according to this revenue procedure for your returns filed on magnetic media. The amount indicators entered for a given type of return indicate type(s) of payment(s) which were made. Example: If position 18 of the Payer/Transmitter "A" Record is "6" (for 1099-INT) and positions 19-27 are "123bbbbbb," this indicates that 3 payment amount fields are present in all of the following Payee "B" Records. The first payment amount field in the Payee "B" Record will represent Earnings from savings and loan associations, credit unions, bank deposits, bearer certificates of deposit, etc., the second will represent Amount of forfeiture, and the third will represent Federal income tax withheld. Enter the Amount Indicators in ASCENDING SEQUENCE, left justify, filling unused positions with blanks. For any further clarification of the Amount Indicator codes, you may contact the service center or National Computer Center Magnetic Media Coordinators listed in Part A, Sec. 13.

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
	Amount Indicators Form 1098—Mortgage Interest Statement (New Form)		For Reporting Mortgage Interest Received from Payer(s) on Form 1098: Amount Code — Amount Type 1 — Mortgage interest received from payer(s) 2 — Optional field for items such as real estate taxes or insurance paid from escrow
	Amount Indicators Form 1099-A—Acquisition or Abandonment of Secured Property (New Form)		For Reporting the Acquisition or Abandonment of Secured Property on Form 1099-A: Amount Code — Amount type 2 — Amount of debt outstanding 3 — Amount of debt satisfied 4 — Fair market value of property at acquisition or abandonment
	Amount Indicators Form 1099-B—Proceeds from Broker and Barter Exchange Transactions		For Reporting Payments on Form 1099-B: Amount Code — Amount Type 2 — Stocks, bonds, etc. (For Forward Contracts see NOTE below.) 3 — Bartering 4 — Federal income tax withheld 6 — Profit or loss realized in 1985 7 — Unrealized profit (or loss) on open contracts—12/31/84 8 — Unrealized profit (or loss) on open contracts—12/31/85 9 — Aggregate profit (or loss)
	NOTE: The Payment Amount field associated with Amount Code 2 may be used to represent a loss when the reporting is for Forward Contracts. Refer to Payee "B" Record-General Field Descriptions, Payment Amount Fields, for instructions in reporting negative amount.		
	Amount Indicators From 1099-DIV—Dividends and Distributions		For Reporting Payments on Form 1099-DIV: Amount Code — Amount Type 1 — Gross dividends and other distributions on stock 2 — Dividends qualifying for exclusion 3 — Dividends not qualifying for exclusion 4 — Federal income tax withheld 5 — Capital gain distributions 6 — Nontaxable distributions (if determinable) 7 — Foreign tax paid 8 — Cash liquidation distributions 9 — Noncash liquidation distributions (Show fair market value)

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
	Amount Indicators Form 1099-G—Certain Government Payments		For Reporting Payments on Form 1099-G: Amount Code — Amount Type 1 — Unemployment compensation 2 — State or local income tax refunds 4 — Federal income tax withheld 5 — Discharge or indebtedness 6 — Taxable grants 7 — Agriculture payments
	Amount Indicators Form 1099-INT—Interest Income		For Reporting Payments on Form 1099-INT: Amount Code — Amount Type 1 — Earnings from savings and loan associations, credit unions, bank deposits, bearer certificates of deposit, etc. 2 — Amount of forfeiture 3 — Federal income tax withheld 4 — Foreign tax paid (if eligible for foreign tax credit) 5 — U.S. Savings Bonds, etc.
	Amount Indicators Form 1099-MISC—Miscellaneous Income (See Notes 1, 2 and 3)		For Reporting Payments on Form 1099-MISC: Amount Code — Amount Type 1 — Rents 2 — Royalties 3 — Prizes and awards 4 — Federal income tax withheld 5 — Fishing boat proceeds 6 — Medical and health care payments 7 — Nonemployee compensation 8 — Direct sales *"indicator"* (see NOTE 1) 9 — Substitute payments in lieu of dividends or interest (see NOTE 2)

NOTE 1: Use Amount Code "8" to report *direct sales* of $5000 or more of consumer products on a buy-sell, deposit-commission, or other basis *for resale*. If *not* for resale, enter a "0" (zero) in tape position 4 of the Payee "B" Record. Please refer to the "B" Record Document Specific Code for clarification. The use of Amount Code "8" actually reflects the *indicator* of *direct sales* and not an actual payment amount or amount code. The corresponding payment amount field in the Payee "B" record MUST be reflected as 0000000100. This does not mean that a payment of $1.00 was made or is being reported. The use of Amount Code "8" relates directly to diskette position 5, Document Specific Code and Note 2 of the Payment Amount Field in the Payee "B" Record.

NOTE 2: Brokers are subject to a new reporting requirement for payments received after 1984. Brokers who transfer securities of a customer for use in a short sale must use Amount Code 9 of Form 1099-MISC to report the aggregate payments received in lieu of dividends or tax-exempt interest on behalf of a customer while the short sale was open. Generally, for substitute payments in lieu of dividends, a broker is required to file a Form 1099-MISC for each affected customer who is *not* an individual. Refer to the 1985 "Instructions for Form 1099 Series, 1098, 5498, and 1096" for detailed information. (The instructions are available from local IRS offices.)

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			

NOTE 3: If you are reporting Excess Golden Parachute Payments, use paper forms 1099-MISC. Do not report Excess golden parachute Payments on magnetic media for tax year 1985. See Part A, Sec. 15 for a definition of an Excess Golden Parachute Payment.

Amount Indicators Form 1099-OID—Original Issue Discount

For Reporting Payments on Form 1099-OID:

Amount Code	Amount Type
1	Total original issue document (ratable) for the tax year covered by the return
2	Stated interest (the regular interest paid on this obligation without regard to any original issue discount)
3	Amount of forfeiture
4	Federal income tax withheld

Amount Indicators Form 1099-PATR—Taxable Distributions Received From Cooperatives

For Reporting Payment on form 1099-PATR:

Amount Code	Amount Type
1	Patronage dividends
2	Nonpatronage distributions
3	Per-unit retain allocations
4	Federal income tax withheld
5	Redemption of nonqualified notices and retai allocations
6	Investment credit (See NOTE)
7	Energy investment credit (see NOTE)
8	Jobs credit (See NOTE)

NOTE: The amounts shown for Amount Indicators "6", "7" and "8" must be reported to the payee; howeve since these amounts are not taxable, they need not be reported to IRS.

Amount Indicators Form 1099-R—Total Distributions from Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, Etc. (See NOTE)

For Reporting Payments on Form 1099-R:

Amount Code	Amount Type
1	Amount includable as income (add amounts codes 2 and 3)
2	Capital gain (for lump-sum distributions only)
3	Ordinary income
4	Federal income tax withheld
5	Employee contributions to profit-sharing or retirement plans
6	IRA, SEP or DEC distributions
8	Net unrealized appreciation in employer securities
9	Other

NOTE: For tax year 1985 reporting, coding is not provided to report to IRS, on magnetic media, any st income tax withheld.

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
	Amount Indicators Form 5498—Individual Retirement Arrangement Information		For Reporting Payments on Form 5498: Amount Code — Amount Type 1 — Regular IRA, SEP or DEC contributions made in calendar year 1985 for tax year 1984 reporting 2 — Rollover IRA, SEP or DEC contributions 3 — Regular IRA, SEP or DEC contributions made in calendar year 1985 and 1986 for tax year 1985 reporting 4 — Allocable life insurance cost included in code 3 for endowment contracts only
	Amount Indicators Form W-2G—Certain Gambling Winnings		For Reporting Payments on Form W-2G: Amount Code — Amount Type 1 — Gross winnings 2 — Federal income tax withheld 7 — Winnings from identical wagers
28	Blank	1	REQUIRED. Enter blank.
29-31	"A" Record Length	3	REQUIRED. This indicates the Record Length, *NOT* the Sector Length. Enter the number of positions used or that you have allowed for the "A" Record. For diskette filing, the actual record length *must* agree with whatever you enter in this field.
32-34	"B" Record Length	3	REQUIRED. This indicates the Record Length, *NOT* the Sector Length. Enter the number of positions used or that you have allowed for the "B" Record. For diskette filing, the actual record length *must* agree with whatever you enter in this field.
35	Blank	1	REQUIRED. Enter blank.
36-40	Transmitter Control Code (TCC)	5	REQUIRED. Enter the 5 character Transmitter Control Code assigned by IRS. See Part A, Sec. 15 for a definition of Transmitter Control Code (TCC). You must have a TCC to file *actual* data on this program.
41	Blank	1	REQUIRED. Enter blank.
42-81	First Payer Name	40	REQUIRED. Enter the name of the payer in the manner in which it is used in normal business. Any extraneous information must be deleted from the name line. Left justify and fill with blanks.
82-120	Second Payer Name	39	REQUIRED. The contents of this field are dependent upon the TRANSFER AGENT INDICATOR in position 121 of this record. If the Transfer Agent Indicator contains a "1", this Field will contain the name of the Transfer Agent. If the Transfer Agent Indicator contains a "0" (zero), this field will contain either a continuation of the First Payer Name field or blanks. Left

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			justify and fill unused positions with blanks. IF NO ENTRIES ARE PRESENT FOR THIS FIELD FILL WITH BLANKS. (See Part A, Sec. 15 for a definition of Transfer Agent.)
121	Transfer Agent Indicator	1	REQUIRED. Identifies the entity in the Second Payer Name Field. (See Part A, Sec. 15 for a definition of Transfer Agent.) *Code* — *Meaning* 1 — The entity in the Second Payer Name field is the Transfer Agent. 0 (zero) — The entity shown is *not* the Transfer Agent (i.e. the Second Payer Name field contains either a continuation of the First Payer Name field or blanks).
122-128	Blank	7	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service Record.
2	Record Type	1	REQUIRED. Enter "A". Must be the second position of each PAYER/TRANSMITTER Record.
3-42	Payer Shipping Address	40	REQUIRED. If the TRANSFER AGENT INDICATOR in position 121 of Sector 1 is a "1" enter the shipping address of the Transfer Agent. Otherwise, enter the shipping address of the payer. Left justify and fill with blanks.
43-82	Payer City, State and ZIP Code	40	REQUIRED. If the TRANSFER AGENT INDICATOR in position 121 of Sector 1 is a "1" enter the city, state and ZIP Code of the Transfer Agent. Otherwise, enter the city, state and ZIP Code of the payer. Left justify and fill with blanks.
83-128	Blank	46	REQUIRED. Enter blanks.
ADDITIONALLY, IF THE PAYER AND THE TRANSMITTER ARE THE SAME, THE "A" RECORD MAY BE TERMINATED WITH SECTOR 2 AS DESCRIBED ABOVE. HOWEVER, IF THE PAYER AND THE TRANSMITTER ARE NOT THE SAME OR THE TRANSMITTER INCLUDES FILES FOR MORE THAN ONE PAYER OR THIS IS A COMBINED FEDERAL/STATE FILING PAYER, THE FOLLOWING ITEMS ARE REQUIRED.			
83-122	First Name line of Transmitter	40	REQUIRED. Enter the name of the transmitter in the manner in which it is used in normal business. The name of the transmitter *must* be constant through the entire file. Left justify and fill with blanks.
123-128	Blank	6	REQUIRED. Enter blanks.
SECTOR 3 (Only used if you are transmitting for someone other than yourself or if you participate in the Combined Federal State Program.)			
1	Record Sequence	1	REQUIRED. Must be a "3". Used to sequence the sectors making a Service Record.

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
2	Record Type	1	REQUIRED. Enter "A". Must be the second position of each PAYER/TRANSMITTER Record.
3-42	Second Name Line of Transmitter	40	REQUIRED. Enter the second name line of the transmitter. Left justify and fill with blanks. IF NO ENTRIES ARE PRESENT FOR THIS FIELD FILL WITH BLANKS.
43-82	Transmitter Mailing Address	40	REQUIRED. Enter the mailing address of the transmitter. Left justify and fill with blanks.
83-122	Transmitter City, State and ZIP Code	40	REQUIRED. Enter the city, state and ZIP Code of the transmitter. Left justify and fill with blanks.
123-128	Blank	6	REQUIRED. Enter blanks.

SEC. 4. PAYER/TRANSMITTER "A" RECORD—RECORD LAYOUT

PAYER/TRANSMITTER "A" RECORD—RECORD LAYOUT

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DISKETTE SEQUENCE NUMBER	PAYER'S FEDERAL EIN	BLANK	COMBINED FEDERAL/STATE FILER	TYPE OF RETURN
1	2	3	4—6	7—15	16	17	18

Sector 1 (Continued)

AMOUNT INDICATORS	BLANK	"A" RECORD LENGTH	"B" RECORD LENGTH	BLANK
19—27	28	29—31	32—34	35

Sector 1 (Continued)

TRANSMITTER CONTROL CODE	BLANK	FIRST PAYER NAME	SECOND PAYER NAME	TRANSFER AGENT INDICATOR	BLANK
36—40	41	42—81	82—120	121	122—128

Sector 2

RECORD SEQUENCE	RECORD TYPE	PAYER SHIPPING ADDRESS	PAYER CITY, STATE AND ZIP CODE	BLANK
1	2	3—42	43—82	83—128

IF THE PAYER AND THE TRANSMITTER ARE THE SAME, THE "A" RECORD MAY BE TERMINATED WITH SECTOR 2 AS ILLUSTRATED ABOVE. HOWEVER, IF THE PAYER AND THE TRANSMITTER ARE NOT THE SAME, OR THE TRANSMITTER INCLUDES FILES FOR MORE THAN ONE PAYER OR THIS IS A COMBINED FEDERAL/STATE PAYER, THE FOLLOWING ITEMS ARE REQUIRED.

Sector 2

RECORD SEQUENCE	RECORD TYPE	PAYER SHIPPING ADDRESS	PAYER CITY, STATE AND ZIP CODE	FIRST NAME LINE OF TRANSMITTER	BLANK
1	2	3—42	43—82	83—122	123—128

Sector 3 (Only used if you are transmitting for someone other than yourself or if you participate in the Combined Federal/State Program.)

RECORD SEQUENCE	RECORD TYPE	SECOND NAME LINE OF TRANSMITTER	TRANSMITTER MAILING ADDRESS	TRANSMITTER CITY, STATE AND ZIP CODE	BLANK
1	2	3—42	43—82	83—122	123—128

SEC. 5. PAYEE "B" RECORDS—GENERAL INFORMATION FOR ALL FORMS

.01 This section contains the general information concerning the Payee "B" Record for all information returns. For detailed description of the record refer to the following:

(a) Sec. 6. PAYEE "B" RECORDS—FIELD DESCRIPTIONS FOR FORMS 1098, 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 1099-R and 5498.

(b) Sec. 8. PAYEE "B" RECORD—FIELD DESCRIPTIONS FOR FORM 1099-A.

(c) Sec. 10. PAYEE "B" RECORD—FIELD DESCRIPTIONS FOR FORM 1099-B.

(d) Sec. 12. PAYEE "B" RECORD—FIELD DESCRIPTIONS FOR FORM W-2G.

.02 The Payee "B" Record contains the payment information from the individual statements. When filing information documents on diskette(s), the format for the Payee "B" Records will vary in relation to the number of payment amount fields being reported. The number of payment amount fields will depend upon the number of Payment Amount Indicator Codes used in positions 19-27 of the Payer/Transmitter "A" Record. For example, if you are reporting 1099-INT, position 18 of the Payer/Transmitter "A" Record will be coded with a "6." If the Amount Indicators used to report this interest are Amount Codes "1," "2," and "3," then diskette positions 19-27 of the "A" Record will be coded "123bbbbbb" (b represents a *blank* position). To correspond with Amount Indicators "1," "2," and "3" of the "A" Record, the "B" Record will contain three payment amount fields. Diskette positions 32-41 of the Payee "B" Record will contain the payment amount to be reported for Amount Code "1" (earnings from savings and loan associations, credit unions, bank deposits, bearer certificates of deposits, etc.); diskette positions 42-51 of the "B" Record would contain the payment amount to be reported for Amount Code "2" (amount of forfeiture; and diskette positions 52-61 of the "B" record would contain the payment amount to be reported for Amount Code "3" (Federal income tax withheld). The First Payee Name Line begins immediately after the last payment amount *that is indicated as being used*. In this example, the First Payee Name Line would begin in diskette position 62.

.03 All payee records *must contain correct payee name and address information* entered in the fields described in this section. Any records containing an invalid TIN (SSN or EIN) and having no address data present will be returned for correction.

.04 IRS must be able to identify the surname associated with the TIN (SSN or EIN) furnished on a statement. The specifications below include a field in the payee records called "Name Control" in which the first four alphabetic characters of the payees' surname or last name are to be entered by the payers. The surname or last name should appear first in the First Payee Name Line of all Payee "B" Records; however, if your records have been developed using the first name first, IRS programs will accept this but, a blank must appear between the first and last name.

.05 If payers are unable to provide the first four characters of the surname, the Name Control Field may be left blank; however, compliance with the following will facilitate IRS computer programs in generating the Name Control.

(a) The surname of the payee whose TIN (SSN or EIN) is shown in the Payee "B" Record should always appear first. If however, you enter the first name first, you must leave a blank space between the first and last name.

(b) In the case of multiple payees, only the surname of the payee whose TIN (SSN or EIN) is shown in the Payee "B" Record, must be present in the First Payee Name Line. Surnames of any other payees in the record must be entered in the Second Payee Name Line.

.06 Provision is also made in these

specifications for data entries required by state or local governments. This should minimize the Payer/Transmitter's programming burden should payers desire to report on diskette to state or local governments. See Part A, Sec. 14, for the Combined Federal/State filing requirements.

.07 Those filers participating in the Combined Federal/State Filing Program *must* have 128 position sectors. Positions 127 and 128 in the Payee "B" Record Sector 2 or 3 *must* contain the appropriate state code for the state to receive the information. The file should also meet the money criteria described in Part A, Sec. 14.11. Do not code for the states unless prior approval to participate has been granted by IRS. See Part A, Sec. 14 for a list of the valid participating state codes. *FORMS 1098, 1099-A, 1099-B AND W-2G CANNOT BE FILED UNDER THE COMBINED FEDERAL/STATE FILING PROGRAM.* Your files must meet all of the requirements specified in Part A, Sec. 14 in order to participate in this program.

SEC. 6 PAYEE "B" RECORD—FIELD DESCRIPTIONS FOR FORMS 1098, 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 1099-R AND 5498

.01 This section contains the general payment information from individual statements for Forms 1098, 1099-A, 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 1099-R and 5498.

.02 In most instances each Payee "B" Record will be composed of two sectors on the diskette with positions 1-41 being a constant format and the variance occurring in positions 42-128 of the first sector and the entire second sector. In those instances where six or more payment amount fields are reported, each Payee "B" Record will be composed of three sectors on the diskette with positions 1-41 of the first sector being a constant format and the variance occurring in positions 42-128 of the first sector and the entire second and third sectors.

RECORD NAME: PAYEE "B" RECORD

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1			
1	Record Sequence	1	REQUIRED. Must be a "1". It is used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-4	Payment Year	2	REQUIRED. Must be the last two digits of the year for which payments are being reported (e.g., if payments were made in 1985 enter "85"). Must be incremented each year.
5	Document Specific Code	1	REQUIRED for Forms 1099-R, 1099-MISC, and 1099-G. For *Form 1099-R*, enter the appropriate value for the Category of total IRA Distribution. For *Form 1099-MISC*, enter the appropriate value for Direct Sales. For *Form 1099-G*, enter the year of income tax refund. FOR ALL OTHER FORMS, ENTER BLANK.
	Category of Total Distribution (Form 1099-R only)		Use only for reporting on *Form 1099-R* to identify the category of Total Distribution. Enter the applicable code from the table below. Code 7 below is *not required* for Amount Indicators 1, 2 and 3. A "0" (zero) is not a valid code for Form 1099-R.

Category	*Code*
Premature distribution (other than codes 2, 3, 4, or 5)	1
Rollover	2
Disability	3
Death	4
Prohibited transaction	5
Other	6
Normal IRA, SEP or DEC distributions	7
Excess contributions refunded plus earnings on such excess contributions	8

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
	Direct Sales (Form 1099-MISC only)		Use only for direct sales reporting on *Form 1099-MISC*. If sales to the recipient of consumer products on a buy-sell, deposit-commission, or any other basis for resale, have amounted to $5,000 or more, ENTER "1". If not for resale, enter "0" (zero). If you are filing 1099-MISC, with an Amount Indicator of "8" in the "A" Record, you must enter a code "1" or "0" in this field. In Part B, Sec. 4, information concerning the direct sales indicator can be found under Amount Indicators, Form 1099-MISC, NOTE 1.
	Refund is for Tax Year (Form 1099-G only)		Use only for reporting the tax year for which the refund was issued. If the payment amount field associated with Amount Indicator 2, Income Tax Refunds, contains a refund, credit or offset that is attributable to an income tax which applies exclusively to income from a trade or business and is not of general application, then enter the ALPHA equivalent of the year of refund from the table below. Otherwise, enter the NUMERIC Year for which the Refund was issued.

Years for which Refund was Issued	Alpha Equivalent
1	A
2	B
3	C
4	D
5	E
6	F
7	G
8	H
9	I
0	J

6-7	Blank	2	REQUIRED. Enter blanks. (Reserved for IRS use). Diskette position 6 is used to indicate a corrected return. Refer to Part A, Sec. 10 for specific instructions on how to file corrected returns using either magnetic media or paper forms.
8-11	Name Control	4	REQUIRED. Enter the first 4 letters of the surname of the payee. Surnames of less than four (4) letters should be left justified, filling the unused positions with blanks. Special characters and imbedded blanks should be removed. IF THE NAME CONTROL IS NOT DETERMINABLE BY THE PAYER, LEAVE THIS FIELD BLANK. A dash (–) or ampersand (&) are the only acceptable special characters.
12	Type of TIN	1	REQUIRED. This field is used to identify the Taxpayer Identification Number (TIN) in positions 13-21 as either an Employer Identification Number, a Social Security Number, or the reason no number is shown. Enter the appropriate code from the table below:

Type of TIN	*TIN*	*Type of Account*
1	EIN	A business or an organization

RECORD NAME: PAYEE "B" RECORD—Continued

Diskette Position	Field Title	Length	Description and Remarks		
SECTOR 1 (Continued)					
			2	SSN	An individual
			9	SSN	The payee is a foreign individual and not a U.S. resident
			blank	N/A	A Taxpayer Identification Number is required but unobtainable due to legitimate cause; e.g. number applied for but not received.
13-21	Taxpayer Identification Number	9	REQUIRED. Enter the valid 9-digit Taxpayer Identification Number of the payee (SSN or EIN, as appropriate). Where an identification number has been applied for but not received or where there is any other legitimate cause for not having an identification number, *enter blanks*. *DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROS*. Any record containing an invalid identification number in this field will be returned for correction.		
22-31	Payer's Account Number for Payee	10	REQUIRED. Payer may use this field to enter the payee's account number. The use of this item will facilitate easy reference to specific records in the payer's file should any questions arise. DO NOT ENTER A TAXPAYER IDENTIFICATION NUMBER IN THIS FIELD. An account number can be any account number assigned by the payer to the payee (i.e., checking account, savings account, etc.). THIS NUMBER WILL HELP TO DISTINGUISH THE INDIVIDUAL PAYEE'S ACCOUNT WITH YOU AND THE SPECIFIC TRANSACTION MADE WITH THE ORGANIZATION, SHOULD MULTIPLE RETURNS BE FILED. This information will be particularly necessary if you need to file a corrected return. You are strongly encouraged to use this field. You may use any number that will help identify the particular transaction that you are reporting.		

RECORD NAME: PAYEE "B" RECORD—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
	Payment Amount Fields		The number of payment amounts is dependent upon and must agree with the number of Amount Indicators present in positions 19-27 of the "A" Record. *THE FIRST PAYEE NAME LINE MUST APPEAR IMMEDIATELY AFTER THE LAST PAYMENT AMOUNT INDICATED AS BEING USED*. For example, if you are reporting 1099-INT and you used only Amount Indicator "3" in the Payer/Transmitter "A" Record, then you will only use one ten position payment amount in the Payee "B" Record, right justified, and the First Payee Name Line will begin in position 42. Each payment field that you allow for, or use, must contain 10 numeric characters (see following NOTE). Do not provide a payment amount field when the corresponding Amount Indicator in the Payer/Transmitter "A" Record is blank. Each payment amount must be entered in dollars and cents. Do not enter dollar

RECORD NAME: PAYEE "B" RECORD—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			signs, commas, decimal points, or *NEGATIVE PAYMENTS* (except those items that reflect a loss on Form 1099-B and must be negative overpunched in the units position). Example: If the Amount Indicators are reflected as "123bbbbbb", the Payee "B" Records must have only 3 payment amount fields. If Amount Indicators are reflected as "12367bbbb", the "B" Records must have only 5 payment amount fields. Payment amounts MUST be right-justified and unused positions MUST be zero-filled. NOTE 1: If any one payment amount exceeds "9999999999" (dollars and cents), as many SEPARATE Payee "B" Records as necessary to contain the total amount MUST be submitted for the Payee. NOTE 2: If you file 1099-MISC and use Amount Code "8" in the Amount Indicator field of the Payer/Transmitter "A" Record, you must enter 0000000100 in the corresponding Payment Amount Field. This will not represent an actual money amount; this is an amount *code*. (Refer to Part B, Sec. 3, NOTE 1, of the Amount Indicators, Form 1099-MISC, for clarification.)
32-41	Payment Amount 1	10	REQUIRED. This amount is identified by the indicator in position 19 of the Payer/Transmitter "A" Record. *This amount must always be present.*
	Determine at this point the number of payment fields to be reported within the Payee "B" Record. This can be determined from the number of Amount Indicators appearing in positions 19-27 of Sector 1 of the Payer/Transmitter "A" Record. Following are the formats for completing positions 42-128 of SECTOR 1, positions 1-128 of SECTOR 2 and positions 1-128 of SECTOR 3, if needed, of the Payee "B" Record. Use the appropriate format as required. SECTOR 3 is only applicable in the Payee "B" Record if you use seven or more payment amount fields.		
42-81	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear immediately after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 above. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
82-121	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name only in this field. If there are multiple payees, this field may be used for those payee's *names* who are not associated with the taxpayer identification number in positions 13-21 above. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
122-128	Blank	7	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING ONE PAYMENT FIELD)—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
43-71	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible).
72-73	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
74-82	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.
83-126	Blank	44	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 14.10. For those states *NOT* participating in this program or for Form 1098 ENTER BLANKS.

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1, of the Payer/Transmitter "A" Record.
52-91	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below.

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
92-128	Blank	37	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record type	2	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.
123-126	Blank	4	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 14.10. For those states NOT participating in this program or for Form 1098 ENTER BLANKS.

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1 of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1 of the Payer/Transmitter "A" Record.
62-101	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear immediately after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
102-128	Blank	27	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviations for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
123-126	Blank	4	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to a sta agency as part of the Combined Federal/State Filing Program enter the valid state code from Part A, Sec. 14.10. For thos states NOT participating in this program or for Form 1098 EN TER BLANKS.

RECORD NAME: PAYEE "B" RECORD (USING FOUR PAYMENT FIELDS)

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 2 Sector 1, of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 2 Sector 1, of the Payer/Transmitter "A" Record.
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position Sector 1, of the Payer/Transmitter "A" Record.
72-111	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after last payment amount indicated as being *used*. Do not enter *dress* information in this field. Enter the name of the pay whose taxpayer identification number appears in positions 13 of Sector 1. If fewer than 40 characters are required, left jus and fill unused positions with blanks. If more space is requi *for the name*, utilize the Second Payee Name Line below there are multiple payees, *only the name* of the payee whose t payer identification number has been provided can be entere this field. The names of the other payees may be entered in Second Payee Name Line field.
112-128	Blank	17	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be "2". Used to sequence the sectors mak up a Service PAYEE Record.
2	Record Type	2	REQURED. Enter "B". Must be the second position of e PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space tha available in the First Payee Name Line, enter the remai portion of the name *only* in this field. If there are multiple ees, this field may be used for those payees' *names* who are associated with the taxpayer identification number in posi 13-21 of Sector 1. Do not enter address information in this f Left justify and fill unused positions with blanks. FILL W BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIE

RECORD NAME: PAYEE "B" RECORD (USING FOUR PAYMENT FIELDS)—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP code only.
123-126	Blank	4	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 14.10. For those states NOT participating in this program or for Form 1098 ENTER BLANKS.

RECORD NAME: PAYEE "B" RECORD (USING FIVE PAYMENT FIELDS)

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1, of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1, of the Payer/Transmitter "A" Record.
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position 22, Section 1, of the Payer/Transmitter "A" Record.
72-81	Payment Amount 5	10	This amount is identified by the amount indicator in position 23, Sector 1, of the Payer/Transmitter "A" Record.
82-121	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required

RECORD NAME: PAYEE "B" RECORD (USING FIVE PAYMENT FIELDS)—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			for the name, utilize the Second Payee Name Line below. there are multiple payees, *only the name* of the payee whose t payer identification number has been provided can be entered this field. The names of the other payees may be entered in Second Payee Name Line field.
122-128	Blank	7	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be "2". Used to sequence the sectors mak up a Service PAYEE Record.
2	Record Type	2	REQUIRED. Enter "B". Must be the second position of e PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space tha available in the First Payee Name Line, enter the remain portion of the name *only* in this field. If there are multiple p ees, this field may be used for those payees' *names* who are associated with the taxpayer identification number in posit 13-21 of Sector 1. Do not enter address information in this fi Left jutify and fill unused positions with blanks. FILL W BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIE
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify fill unused positions with blanks. Address MUST be pres This field MUST NOT contain any data other than payee's n ing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused sitions with blanks. Do *not* enter state and ZIP Code informa in this field. (If the payee lives outside of the United States clude their current mailing address and spell out the name o country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *M* use valid U.S. Postal Service abbreviations for states as sh in Part A, Sec. 16. Use this field for state information onl
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by U.S. Postal Service. If only the first 5 digits are known, left tify and fill the unused positions with blanks. Use this field the ZIP Code only.
123-126	Blank	4	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to a agency as part of the Combined Federal/State Filing Prog enter the valid state code from Part A, Sec. 14.10. For t states NOT participating in this program or for Form 1098 TER BLANKS.

RECORD NAME: PAYEE "B" RECORD (USING SIX PAYMENT FIELDS)

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1 of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1 of the Payer/Transmitter "A" Record.
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position 22, Sector 1 of the Payer/Transmitter "A" Record.
72-81	Payment Amount 5	10	This amount is identified by the amount indicator in position 23, Sector 1 of the Payer/Transmitter "A" Record.
82-91	Payment Amount 6	10	This amount is identified by the amount indicator in position 24, Sector 1 of the Payer/Transmitter "A" Record.
92-128	Blank	37	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
43-82	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
83-122	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
123-128	Blank	6	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING SIX PAYMENT FIELDS)—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be a "3". Used to sequence the sectors ma ing up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of ea PAYEE Record.
3-31	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused p sitions with blanks. Do *not* enter state and ZIP Code informati in this field. (If the payee lives outside of the United States, i clude their current mailing address and spell out the name of t country if possible.)
32-33	Payee State	2	REQUIRED. Enter the abbreviations for the state. You *MU* use valid U.S. Postal Service abbreviations for states as sho in Part A, Sec. 16. Use this field for state information only
34-42	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by t U.S. Postal Service. If only the first 5 digits are known, left j tify and fill the unused positions with blanks. Use this field the ZIP Code only.
43-126	Blank	84	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to a st agency as part of the Combined Federal/State Filing Progra enter the valid state code from Part A, Sec. 14.10. For th states NOT participating in this program or for Form 1098 E TER BLANKS.

RECORD NAME: PAYEE "B" RECORD (USING SEVEN PAYMENT FIELDS)

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position Sector 1 of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position Sector 1 of the Payer/Transmitter "A" Record.
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position Sector 1 of the Payer/Transmitter "A" Record.
72-81	Payment Amount 5	10	This amount is identified by the amount indicator in position Sector 1 of the Payer/Transmitter "A" Record.
82-91	Payment Amount 6	10	This amount is identified by the amount indicator in position Sector 1 of the Payer/Transmitter "A" Record.
92-101	Payment Amount 7	10	This amount is identified by the amount indicator in position Sector 1 of the Payer/Transmitter "A" Record.

RECORD NAME: PAYEE "B" RECORD (USING SEVEN PAYMENT FIELDS)—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
102-128	Blank	27	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
43-82	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
83-122	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
123-128	Blank	6	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be a "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-31	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)

RECORD NAME: PAYEE "B" RECORD (USING SEVEN PAYMENT FIELDS)—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
32-33	Payee State	2	REQUIRED. Enter the abbreviations for the state. You *MU* use valid U.S. Postal Service abbreviations for states as sho in Part A, Sec. 16. Use this field for state information only
34-42	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by U.S. Postal Service. If only the first 5 digits are known, left j tify and fill the unused positions with blanks. Use this field the ZIP Code only.
43-126	Blank	84	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to a s agency as part of Combined Federal/State Filing Program. e the valid state code from Part A, Sec. 14.10. For those st NOT participating in this program or for Form 1098 ENT BLANKS.

RECORD NAME: PAYEE "B" RECORD (USING EIGHT PAYMENT FIELDS)

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position Sector 1 of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position Sector 1 of the Payer/Transmitter "A" Record.
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position Sector 1 of the Payer/Transmitter "A" Record.
72-81	Payment Amount 5	10	This amount is identified by the amount indicator in position Sector 1 of the Payer/Transmitter "A" Record.
82-91	Payment Amount 6	10	This amount is identified by the amount indicator in position Sector 1 of the Payer/Transmitter "A" Record.
92-101	Payment Amount 7	10	This amount is identified by the amount indicator in position Sector 1 of the Payer/Transmitter "A" Record.
102-111	Payment Amount 8	10	This amount is identified by the amount indicator in position Sector 1 of the Payer/Transmitter "A" Record.
112-128	Blank	17	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors ing up a Service PAYEE Record.

RECORD NAME: PAYEE "B" RECORD (USING EIGHT PAYMENT FIELDS)—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	First payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter address information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
43-82	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
83-122	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
123-128	Blank	6	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be a "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B." Must be the second position of each PAYEE Record.
3-31	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
32-33	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
34-42	Payee ZIP CODE	9	REQUIRED, Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.

RECORD NAME: PAYEE "B" RECORD (USING EIGHT PAYMENT FIELDS)—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
43-126	Blank	84	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to a stat agency as part of the Combined Federal/State Filing Program enter the valid state code from Part A, Sec. 14.10. For thos states NOT participating in this program or for Form 1098 EN TER BLANKS.

RECORD NAME: PAYEE "B" RECORD (USING NINE PAYMENT FIELDS)

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 2 Sector 1 of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 2 Sector 1 of the Payer/Transmitter "A" Record.
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position 2 Sector 1 of the Payer/Transmitter "A" Record.
72-81	Payment Amount 5	10	This amount is identified by the amount indicator in position 2 Sector 1 of the Payer/Transmitter "A" Record.
82-91	Payment Amount 6	10	This amount is identified by the amount indicator in position 2 Sector 1 of the Payer/Transmitter "A" Record.
92-101	Payment Amount 7	10	This amount is identified by the amount indicator in position 2 Sector 1 of the Payer/Transmitter "A" Record.
102-111	Payment Amount 8	10	This amount is identified by the amount indicator in position 2 Sector 1 of the Payer/Transmitter "A" Record.
112-121	Payment Amount 9	10	This amount is identified by the amount indicator in position 2 Sector 1 of the Payer/Transmitter "A" Record.
122-128	Blank	7	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors m ing up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of e PAYEE Record.
3-42	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after last payment amount indicated as being *used*. Do not enter *dress* information in this field. Enter the name of the pa whose taxpayer identification number appears in positions 13

RECORD NAME: PAYEE "B" RECORD (USING NINE PAYMENT FIELDS)—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
			of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
43-82	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
83-122	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
123-128	BLANK	6	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be a "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-31	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
32-33	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
34-42	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.
43-126	Blank	84	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 14.10. For those states NOT participating in this program or for Form 1098 ENTER BLANKS.

SEC. 7. PAYEE "B" RECORD—RECORD LAYOUTS FOR FORMS 1098, 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 1099-R AND 5498

PAYEE "B" RECORD—RECORD LAYOUT (USING ONE PAYMENT AMOUNT FIELD)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATIO NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	BLANK
22—31	32—41	42—81	82—121	122—128

Sector 2

RECORD SEQUENCE	RECORD TYPE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK	STATE CODE
1	2	3—42	43—71	72—73	74—82	83—126	127—12

PAYEE "B" RECORD—RECORD LAYOUT (USING TWO PAYMENT AMOUNT FIELDS)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYE IDENTIFICA NUMBE
1	2	3—4	5	6—7	8—11	12	13—21

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—91	92—128

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK	ST C
1	2	3—42	43—82	83—111	112—113	114—122	123—126	127

PAYEE "B" RECORD—RECORD LAYOUT (USING THREE PAYMENT AMOUNT FIELDS)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAY IDENTIFICA NUMBE
1	2	3—4	5	6—7	8—11	12	13—2

PAYEE "B" RECORD—RECORD LAYOUT (USING THREE PAYMENT AMOUNT FIELDS)—Continued

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52-61	62—101	102—128

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE
1	2	3—42	43—82	83—111	112—113	114—122

Sector 2 (Continued)

BLANK	STATE CODE
123—126	127—128

PAYEE "B" RECORD—RECORD LAYOUT (USING FOUR PAYMENT AMOUNT FIELDS)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—61	62—71	72—111	112—128

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE
1	2	3—42	43—82	83—111	112—113	114—122

Sector 2 (Continued)

BLANK	STATE CODE
123—126	127—128

PAYEE "B" RECORD—RECORD LAYOUT (USING FIVE PAYMENT AMOUNT FIELDS)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	PAYMENT AMOUNT 5	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—61	62—71	72—81	82—121	122—12

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK	STATE CODE
1	2	3—42	43—82	83—111	112—113	114—122	123—126	127—1

PAYEE "B" RECORD—RECORD LAYOUT (USING SIX PAYMENT AMOUNT FIELDS)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATIO NUMBER
1	2	3-14	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	PAYMENT AMOUNT 5	PAYMENT AMOUNT
22—31	32—41	42—51	52—61	62—71	72—81	82—91

Sector 1 (Continued)

BLANK
92—128

Sector 2

RECORD SEQUENCE	RECORD TYPE	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	BLANK
1	2	3—42	43—82	83—122	123—128

Sector 3

RECORD SEQUENCE	RECORD TYPE	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK	STATE CODE
1	2	3—31	32—33	34—42	43—126	127—128

PAYEE "B" RECORD—RECORD LAYOUT (USING SEVEN PAYMENT AMOUNT FIELDS)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	PAYMENT AMOUNT 5	PAYMENT AMOUNT 6
22—31	32—41	42—51	52—61	62—71	72—81	82—91

Sector 1 (Continued)

PAYMENT AMOUNT 7	BLANK
92—101	102—128

Sector 2

RECORD SEQUENCE	RECORD TYPE	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	BLANK
1	2	3—42	43—82	83—122	123—128

Sector 3

RECORD SEQUENCE	RECORD TYPE	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK	STATE CODE
1	2	3—31	32—33	34—42	43—126	127—128

PAYEE "B" RECORD—RECORD LAYOUT (USING EIGHT PAYMENT AMOUNT FIELDS)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	PAYMENT AMOUNT 5	PAYMENT AMOUNT 6
22—31	32—41	42—51	52—61	62—71	72—81	82—91

Sector 1 (Continued)

PAYMENT AMOUNT 7	PAYMENT AMOUNT 8	BLANK
92—101	102—111	112—128

PAYEE "B" RECORD—RECORD LAYOUT (USING EIGHT PAYMENT AMOUNT FIELDS)—Continued

Sector 2

RECORD SEQUENCE	RECORD TYPE	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	BLANK
1	2	3—42	43—82	83—122	123—128

Sector 3

RECORD SEQUENCE	RECORD TYPE	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK	STATE CODE
1	2	3—31	32—33	34—42	43—126	127—128

PAYEE "B" RECORD—RECORD LAYOUT (USING NINE PAYMENT AMOUNT FIELDS)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	PAYMENT AMOUNT 5	PAYMENT AMOUNT 6
22—31	32—41	42—51	52—61	62—71	72—81	82—91

Sector 1 (Continued)

PAYMENT AMOUNT 7	PAYMENT AMOUNT 8	PAYMENT AMOUNT 9	BLANK
92—101	102—111	112—121	122—128

Sector 2

RECORD SEQUENCE	RECORD TYPE	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	BLANK
1	2	3—42	43—82	83—122	123—128

Sector 3

RECORD SEQUENCE	RECORD TYPE	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK	STATE CODE
1	2	3—31	32—33	34—42	43—126	127—128

SEC. 8. PAYEE "B" RECORDS—FIELD DESCRIPTIONS FOR FORM 1099-A

.01 This section contains the general payment information from individual statements for Form 1099-A. For detailed explanations of the 1099-A fields request a copy of the 1985 "Instructions for Form 1099 Series, 1098, 5498 and 1096," available from local IRS offices.

.02 For Form 1099-A, SECTOR 3 will be required if there is more than one payment field to be reported in the Payee "B" Record.

.03 FORM 1099-A CANNOT BE FILED UNDER THE COMBINED FEDERAL/STATE FILING PROGRAM.

RECORD NAME: PAYEE "B" RECORD
FORM 1099-A

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1			
1	Record Sequence	1	REQUIRED. Must be a "1". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-4	Payment Year	2	REQUIRED. Must be the last two digits of the year for which payments are being reported (e.g., if payments were made in 1985 enter "85"). Must be incremented each year.
5	Document Specific Code	1	REQUIRED. For Form 1099-A enter blank.
6-7	Blank	2	REQUIRED. Enter blanks. (Reserved for IRS use). Diskette position 6 is used to indicate a corrected return. Refer to Part A, Sec. 10 for specific instructions on how to file corrected returns utilizing either magnetic media or paper forms.
8-11	Name Control	4	REQUIRED. Enter the first 4 letters of the surname of the payee. Surnames of less than four (4) letters should be left justified, filling the unused positions with blanks. Special characters and imbedded blanks should be removed. IF THE NAME CONTROL IS NOT DETERMINABLE BY THE PAYER, LEAVE THIS FIELD BLANK. A dash (—) or ampersand (&) are the only acceptable special characters.
12	Type of TIN	1	REQUIRED. This field is used to identify the Taxpayer Identification Number (TIN) in positions 13-21 as either an Employer Identification Number, a Social Security Number, or the reason no number is shown. Enter the appropriate code from the table below: *Type of TIN* / *TIN* / *Type of Account* 1 / EIN / A business or an organization 2 / SSN / An individual 9 / SSN / The payee is a foreign individual and not a U.S. resident blank / N/A / A Taxpayer Identification Number is required but unobtainable due to legitimate cause; e.g. number applied for but not received.

RECORD NAME: PAYEE "B" RECORD—Continued
FORM 1099-A

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
13-21	Taxpayer Identification Number	9	REQUIRED. Enter the valid 9-digit Taxpayer Identificatio Number of the payee (SSN or EIN, as appropriate). Where a identification number has been applied for but not received c where there is any other legitimate cause for not having an ide tification number, *enter blanks*. *DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9 OR ALL ZEROS*. Any record containing an invalid identificatio number in this field will be returned for correction.
22-31	Payer's Account Number for Payee	10	REQUIRED. Payer may use this field to enter the payee's a count number. The use of this item will facilitate easy referen to specific records in the payer's file should any questions aris DO NOT ENTER A TAXPAYER IDENTIFICATION NUM BER IN THIS FIELD. Enter blanks if the Payer's Accou Number for Payee is not to be entered in this field. An accou number can be any account number assigned by the payer to t payee (i.e., checking account, savings account, etc.). TH NUMBER WILL HELP TO DISTINGUISH THE INDIVI UAL PAYEE'S ACCOUNT WITH YOU AND THE SPECIF TRANSACTION MADE WITH THE ORGANIZATIO SHOULD MULTIPLE RETURNS BE FILED. This informati will be particularly necessary if you need to file a corrected turn. You are strongly encouraged to use this field. You may u any number that will help identify the particular transaction t you are reporting.
	Payment Amount Fields		The number of payment amounts is dependent upon and m agree with the number of Amount Indicators present in positio 19-27 of Sector 1 of the "A" Record. The First Payee Na Line *must* appear immediately after the last payment amount dicated as being used. For example, if you are report 1099-INT and you used only Amount Indicator "3" in the Pay Transmitter "A" Record, then you will only use one ten posit payment amount in the Payee "B" Record, right justified, the First Payee Name Line will begin in position 42. Each p ment field that you allow for, or use, must contain 10 num characters (see following NOTE). Do not provide a paym amount field when the corresponding Amount Indicator in Payer/Transmitter "A" Record is blank. Each payment amo must be entered in dollars and cents. Do not enter dollar sig commas, decimal points, or *NEGATIVE PAYMENTS* (exc those items that reflect a loss on Form 1099-B and must be n ative overpunched in the units position). Example: If the Amount Indicators are reflected "123bbbbbb", the Payee "B" Records must have only 3 paym amount fields. If Amount Indicators are reflected "12367bbbb", the "B" Records must have only 5 paym amount fields. Payment amounts MUST be right-justified unused portions MUST be zero-filled. NOTE 1: If any one payment amount exceeds "99999999 (dollars and cents), as many SEPARATE Payee "B" Record necessary to contain the total amount MUST be submitted the Payee.

RECORD NAME: PAYEE "B" RECORD (USING ONE PAYMENT FIELD)
FORM 1099-A

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			NOTE 2: If you file 1099-MISC and use Amount Code "8" in the Amount Indicator field of the Payer/Transmitter "A" Record, you must enter 0000000100 in the corresponding Payment Amount Field. This will not represent an actual money amount; this is an amount *code*. (Refer to Part B, Sec. 4, NOTE 1, of the Amount Indicators, Form 1099-MISC, for clarification.)
32-41	Payment Amount 1	10	REQUIRED. This amount is identified by the indicator in position 19 of Sector 1 of the Payer/Transmitter "A" Record. *This amount must always be present.*
	Determine at this point the number of payment fields to be reported within the Payee "B" Record. This can be determined from the number of Amount Indicators appearing in positions 19-27 of Sector 1 of the Payer/Transmitter "A" Record. Following are the formats for completing positions 42-128 of SECTOR 1, positions 1-128 of SECTOR 2 and positions 1-128 of SECTOR 3, if needed, of the Payee "B" Record. *FOR FORM 1099-A SECTOR 3 WILL BE REQUIRED IF THERE IS MORE THAN ONE PAYMENT FIELD TO BE REPORTED IN THE PAYEE "B" RECORD.* Use the appropriate format as required.		
42-81	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear immediately after the last payment amount indicated as being *used*. Do not enter *address* information on this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 above. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
81-121	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 above. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
122-128	Blank	7	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING ONE PAYMENT FIELD)—Continued
FORM 1099-A

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 2			
1	Record Sequence	1	REQUIRED Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.

RECORD NAME: PAYEE "B" RECORD (USING ONE PAYMENT FIELD)—Continued
FORM 1099-A

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
43-71	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state the ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country is possible.)
72-73	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
74-82	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.
83-88	Lender's Date of Acquisition or Abandonment	6	REQUIRED *FOR FORM 1099-A ONLY*. Enter the date of your acquisition of the secured property or the date you first knew or had reason to know that the property was abandoned in the format MMDDYY. DO NOT ENTER HYPHENS OR SLASHES.
89	Liability Indicator	1	REQUIRED *FOR FORM 1099-A ONLY*. Enter the appropriate indicator from table below: *Indicator* — *Usage* 1 — Borrower is personally liable for repayment of the debt. Blank — Borrower is *not* liable for repayment of the debt.
90-126	Description	37	REQUIRED *FOR FORM 1099-A ONLY*. Enter a brief description of the property. For example, for real property, enter the address, section, lot and block. For personal property, enter the type, make and model (e.g., Car-1985 Buick Regal or Office Equipment, etc.).
127-128	Blank	2	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)
FORM 1099-A

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1, of the Payer/Transmitter "A" Record.
52-91	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 of Sector 1. If fewer than 40 character are required, left justify and fill unused positions with blanks. If more space is required, utilize the Second Payee Name Line below. If there are multiple payees, only the name of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
92-128	Blank	37	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	2	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQURIED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.
123-128	Blank	6	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENTS FIELDS)—Continued
FORM 1099-A

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be "3". Used to sequence the sectors mak up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of e PAYEE Record.
3-82	Blank	80	REQUIRED. Enter blanks.
83-88	Lender's Date of Acquisition or Abandonment	6	REQUIRED FOR FORM 1099-A ONLY. Enter the date of acquisition of the secured property or the date you first knev had reason to know that the property was abandoned in the mat MMDDYY. DO NOT ENTER HYPHENS OR SLASH
89	Liability Indicator	1	REQUIRED *FOR FORM 1099-A ONLY*. Enter the approp indicator from table below: *Indicator* — Usage 1 — Borrower is personally liable for repayme the debt. Blank — Borrower is *not* liable for repayment o debt.
90-126	Description	37	REQUIRED *FOR FORM 1099-A ONLY*. Enter a brief des tion of the property. For example, for real property, ente address, section, lot and block. For personal property, ente type, make and model (e.g., Car-1985 Buick Regal or C Equipment, etc.).
127-128	Blank	2	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)
FORM 1099-A

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in positio Sector 1 of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in positio Sector 1 of the Payer/Transmitter "A" Record.
62-101	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear aft last payment amount indicated as being *used*. Do not ent *dress* information in this field. Enter the name of the whose taxpayer identification number appears in positions of Sector 1. If fewer than 40 characters are required, left and fill unused positions with blanks. If more space is re *for the name*, utilize the Second Payee Name Line field If there are multiple payees, *only the name* of the payee

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)—Continued
FORM 1099-A

Diskette Position	Field Title	Length	Description and Remarks
			taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
102-128	Blank	27	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B." Must be the second position of each PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 of Sector 1. Do not enter address information in this field. Let justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.
123-128	Blank	6	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)—Continued
FORM 1099-A

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be "3". Used to sequence the sectors making up a Service PAYEE Record.

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)—Continued
FORM 1099-A

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of ea PAYEE Record.
3-83	Blank	80	REQUIRED. Enter blanks.
83-88	Lender's Date of Acquisition or Abandoment	6	REQUIRD FOR FORM 1099-A ONLY. Enter the date of yo acquisition of the secured property or the date you first knew had reason to know that the property was abandoned in the fo mat MMDDYY. DO NOT ENTER HYPHENS OR SLASHE
89	Liability Indicator	1	REQUIRED *FOR FORM 1099-A ONLY*. Enter the appropri indicator from the table below: *Indicator* — *Usage* 1 — Borrower is personally liable repayment of the debt. Blank — Borrower is *not* liable for rep ment of the debt.
90-126	Description	37	REQUIRED *FOR FORM 1099-A ONLY*. Enter a brief descr tion of the property. For example, for real property, enter address, section, lot and block. For personal property, enter type, make and model (e.g., Car-1985 Buick Regal or Off Equipment, etc.)
127-128	Blank	2	REQUIRED. Enter blanks.

SEC. 9. PAYEE "B" RECORD—RECORD LAYOUT FOR FORM 1099-A

PAYEE "B" RECORD—RECORD LAYOUT (USING ONE PAYMENT AMOUNT FIELD)
FORM 1099-A

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATIO NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	BLANK
22—31	32—41	42—81	82—121	122—128

Sector 2

RECORD SEQUENCE	RECORD TYPE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE
1	2	3—42	43—71	72—73	74—82

PAYEE "B" RECORD—RECORD LAYOUT (USING ONE PAYMENT AMOUNT FIELDS)—Continued
FORM 1099-A

Sector 2 (Continued)

LENDER'S DATE OF ACQUISITION OR ABANDONMENT	LIABILITY INDICATOR	DESCRIPTION	BLANK
83—88	89	90—126	127—128

PAYEE "B" RECORD—RECORD LAYOUT (USING TWO PAYMENT AMOUNT FIELDS)
FORM 1099-A

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—91	92—128

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK
1	2	3—42	43—82	83—111	112—113	114—122	123—128

Sector 3

RECORD SEQUENCE	RECORD TYPE	BLANK	LENDER'S DATE OF ACQUISITION OR ABANDONMENT	LIABILITY INDICATOR	DESCRIPTION	BLANK
1	2	3—82	83—88	89	90—126	127—128

PAYEE "B" RECORD—RECORD LAYOUT (USING THREE PAYMENT AMOUNT FIELDS)
FORM 1099-A

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

PAYEE "B" RECORD—RECORD LAYOUT (USING THREE PAYMENT AMOUNT FIELDS)—Continued
FORM 1099-A

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—61	62—101	102—128

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLAN
1	2	3—42	43—82	83—111	112—113	114—122	123—

Sector 3

RECORD SEQUENCE	RECORD TYPE	BLANK	LENDER'S DATE OF ACQUISITION OR ABANDONMENT	LIABILITY INDICATOR	DESCRIPTION	BLANK
1	2	3—82	83—88	89	90—126	127—128

SEC. 10. PAYEE "B" RECORDS—FIELD DESCRIPTIONS FOR FORM 1099-B

.01 This section contains the general payment information from individual statements for Form 1099-B. For detailed explanations of the 1099-B fields request a copy of the 1985 "Instructions for Form 1099 Series, 1098, 5498, and 1096" available from local IRS offices.

.02 For Form 1099-B, SECTOR 3 will be required if there is more than one payment field to be reported in t Payee "B" Record.

.03 FORM 1099-B CANNOT I FILED UNDER THE COMBINI FEDERAL/STATE FILING PR GRAM.

RECORD NAME: PAYEE "B" RECORD
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1			
1	Record Sequence	1	REQUIRED. Must be a "1". Used to sequence the sectors m ing up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of e PAYEE Record.
3-4	Payment Year	2	REQUIRED. Must be the last two digits of the year for wh payments are being reported (e.g. if payments were made 1985 enter "85"). Must be incremented each year.
5	Document Specific Code	1	REQUIRED. For Form 1099-B enter blank.
6-7	Blank	2	REQUIRED. Enter blanks. (Reserved for IRS use.) Diskette sition 6 is used to indicate a corrected return. Refer to Part

RECORD NAME: PAYEE "B" RECORD
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			Sec. 10 for specific instructions on how to file corrected returns utilizing either magnetic media or paper forms.
8-11	Name Control	4	REQUIRED. Enter the first 4 letters of the surname of the payee. Surnames of less than four (4) letters should be left justified, filling the unused positions with blanks. Special characters and imbedded blanks should be removed. IF THE NAME CONTROL IS NOT DETERMINABLE BY THE PAYER, LEAVE THIS FIELD BLANK. A dash (–) or ampersand (&) are the only acceptable special characters.
12	Type of TIN	1	REQUIRED. This field is used to identify the Taxpayer Identification Number (TIN) in positions 13-21 as either an Employer Identification Number, a Social Security Number, or the reason no number is shown. Enter the appropriate code from the table below: *Type of TIN* / *TIN* / *Type of Account* 1 / EIN / A business or an organization 2 / SSN / An individual 9 / SSN / The payee is a foreign individual and not a U.S. resident blank / N/A / A Taxpayer Identification Number is required but unobtainable due to legitimate cause; e.g. number applied for but not received.
13-21	Taxpayer Identification Number	9	REQUIRED. Enter the valid 9-digit Taxpayer Identification Number of the payee (SSN or EIN, as appropriate). Where an identification number has been applied for but not received or where there is any other legitimate cause for not having an indentification number, *enter blanks*. *DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROS*. Any record containing an invalid identification number in this field will be returned for correction
22-31	Payer's Account Number for Payee	10	REQUIRED. Payer may use this field to enter the payee's account number. The use of this item will facilitate easy reference to specific records in the payer's file, should any questions arise. DO NOT ENTER A TAXPAYER IDENTIFICATION NUMBER IN THIS FIELD. Enter blanks if the Payer's Account Number for Payee is not to be entered in this field. An account number can be any account number assigned by the payer to the payee (i.e., checking account, savings account, etc.). THIS NUMBER WILL HELP TO DISTINGUISH THE INDIVIDUAL PAYEE'S ACCOUNT WITH YOU AND THE SPECIFIC TRANSACTION MADE WITH THE ORGANIZATION, SHOULD MULTIPLE RETURNS BE FILED. This information will be particularly necessary if you need to file a corrected re-

RECORD NAME: PAYEE "B" RECORD
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			turn. You are strongly encouraged to use this field. You may us any number that will help identify the particular transaction tha you are reporting.
	Payment Amount Fields		The number of payment amounts is dependent on the number o Amount Indicators present in positions 19-27 of Sector 1 of th "A" Record. The First Payee Name Line *must* appear immedi ately after the last payment amount indicated as being used. Fo example, if you are reporting 1099-INT and you used onl Amount Indicator "3" in the Payer/Transmitter "A" Record, the you will only use one ten position payment amount in the Paye "B" Record, right justified, and the First Payee Name Line wi begin in position 42. Each payment field that you allow for, o use, must contain 10 numeric characters (see following NOTE Do not provide a payment amount field when the correspondin Amount Indicator in the Payer/Transmitter "A" Record is blank Each payment amount must be entered in dollars and cents. Do not enter dollar signs, commas, decimal points, or *NEGA TIVE PAYMENTS* (except those items that reflect a loss on Form 1099-B and must be negative overpunched in the units position Example: If the Amount Indicators are reflected a "123bbbbbb", the Payee "B" Records must have only 3 payme amount fields. If Amount Indicators are reflected a "12367bbbb", the "B" Records must have only 5 payme amount fields. Payment amounts MUST be right-justified an unused portions MUST be zero-filled. NOTE: 1 If any one payment amount exceeds "999999999 (dollars and cents), as many SEPARATE Payee "B" Records necessary to contain the total amount MUST be submitted f the Payee. NOTE 2: If you file 1099-MISC and use Amount Code "8" the Amount Indicator field of the Payer/Transmitter "A" Recor you must enter 0000000100 in the corresponding Payme Amount Field. This will not represent an actual money amou this is an amount *code*. (Refer to PART B., Sec. 3, NOTE 1, the Amount Indicators, Form 1099-MISC, for clarification.)
32-41	Payment Amount 1	10	REQUIRED. This amount is identified by the indicator in po tion 19 of Sector 1 of the Payer/Transmitter "A" Record. *Th amount must always be present.*
			Determine at this point the number of payment fields to be reported within the Payee "B" Record. This c be determined from the number of Amount Indicators appearing in positions 19-27 of Sector 1 of the Pay Transmitter "A" Record. Following are the formats for completing positions 42-128 of SECTOR 1, positio 1-128 of SECTOR 2 and positions 1-128 of SECTOR 3, if needed, of the Payee "B" Record. *FOR FOR 1099-B SECTOR 3 WILL BE REQUIRED IF THERE IS MORE THAT ONE PAYMENT FIELD TO BE R PORTED IN THE PAYEE "B" RECORD.* Use the appropriate format as required.

RECORD NAME: PAYEE "B" RECORD (USING ONE PAYMENT FIELD
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-81	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear immediately after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 above. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
82-121	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 above. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
122-128	Blank	7	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B." Must be the second position of each PAYEE Record.
3-42	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
43-71	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
72-73	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
74-82	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.
83-85	Blank	3	REQUIRED. Enter blanks.

RECORD NAME PAYEE "B" RECORD (USING ONE PAYMENT FIELD)—Continued
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
86	Date of Sale Indicator	1	REQUIRED *FOR FORM 1099-B ONLY*. Enter appropriate indicator from table below: *Indicator* — *Usage* S — Date of Sale is the actual settlement date blank — Date of Sale is the trade date or this is an aggregate transaction
87-92	Date of Sale	6	REQUIRED *FOR FORM 1099-B ONLY*. Enter the trade date or the actual settlement date of the transaction in the format MMDDYY. Enter blanks if this is an aggregate transaction. DO NOT ENTER HYPHENS OR SLASHES.
93-100	CUSIP No.	8	REQUIRED *FOR FORM 1099-B ONLY*. Enter the CUSIP (Committee on Uniform Security Identification Procedures) number of the items reported for Amount Indicator "2" (Stocks, bonds, etc.). Enter blanks if this is an aggregate transaction. Enter "0" (zeroes) if the number is not available. For CUSIP numbers with more than 8 characters, supply the *first* 8.
101-126	Description	26	REQUIRED *FOR FORM 1099-B ONLY*. Enter a brief description of the item or services for which the proceeds are being reported. If fewer than 26 characters are required, left justify and fill unused positions with blanks. For regulated futures contracts, enter the customer account number. Enter blanks if this is an aggregate transaction.
127-128	Blank	2	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1, of the Payer/Transmitter "A" Record.
52-91	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required for the name, utilize the Second Payee Name Line below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)—Continued
FORM 1099-B

kette ition	Field Title	Length	Description and Remarks
128	Blank	37	REQUIRED. Enter blanks.
CTOR 2			
	Record Sequence	1	REQUIRED. Must be "2". Used to sequence the sectors making up a Service PAYEE Record.
	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
2	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than payee's mailing address.
111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.
128	Blank	6	REQUIRED. Enter blanks.
CTOR 3			
	Record Sequence	1	REQUIRED. Must be "3". Used to sequence the sectors making up a Service PAYEE Record.
	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
5	Blank	83	REQUIRED. Enter blanks.
	Date of Sale Indicator	1	REQUIRED *FOR FORM 1099-B ONLY*. Enter appropriate indicator from table below: *Indicator* — *Usage* S — Date of Sale is the actual settlement date

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)—Continued
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
			blank — Date of Sale is the trade date or this is an aggregate transaction
87-92	Date of Sale	6	REQUIRED *FOR FORM 1099-B ONLY*. Enter the trade date or the actual settlement date of the transaction in the format MMDDYY. Enter blanks if this is an aggregate transaction. DO NOT ENTER HYPHENS OR SLASHES.
93-100	CUSIP No.	8	REQUIRED *FOR FORM 1099-B ONLY*. Enter the CUSIP (Committee on Uniform Security Identification Procedures) number of the items reported for Amount Indicator "2" (Stocks, bonds, etc.). Enter blanks if this is an aggregate transaction. Enter "0" (zeroes) if the number is not available. For CUSIP numbers with more than 8 characters, supply the *first* 8.
101-126	Description	26	REQUIRED *FOR FORM 1099-B ONLY*. Enter a brief description of the item or services for which the proceeds are being reported. If fewer than 26 characters are required, left justify and fill unused positions with blanks. For regulated futures contracts, enter the customer account number. Enter blanks if this is an aggregate transaction.
127-128	Blank	2	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1 of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1 of the Payer/Transmitter "A" Record.
62-101	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
102-128	Blank	27	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)—Continued
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each payee record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name only in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.
123-128	Blank	6	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-85	Blank	83	REQUIRED. Enter blanks.
86	Date of Sale Indicator	1	REQUIRED *FOR FORM 1099-B ONLY*. Enter appropriate indicator from table below: *Indicator* — *Usage* S — Date of Sale is the actual settlement date

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)—Continued
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
		blank	Date of Sale is the trade date or this is an aggregate transaction
87-92	Date of Sale	6	*REQUIRED FOR FORM 1099-B ONLY*. Enter the trade date or the actual settlement date of the transaction in the format MMDDYY. Enter blanks if this is an aggregate transaction. DO NOT ENTER HYPHENS OR SLASHES.
93-100	CUSIP No.	8	REQUIRED *FOR FORM 1099-B ONLY*. Enter the CUSIP (Committee on Uniform Security Identification Procedures) number of the items reported for Amount Indicator "2" (Stocks, bonds, etc.). Enter blanks if this is an aggregate transaction. Enter "0" (zeroes) if the number is not available. For CUSIP numbers with more than 8 characters, supply the *first* 8.
101-126	Description	26	REQUIRED *FOR FORM 1099-B ONLY*. Enter a brief description of the item or services for which the proceeds are being reported. If fewer than 26 characters are required, left justify and fill unused positions with blanks. For regulated futures contracts, enter the customer account number. Enter blanks if this is an aggregate transaction.
127-128	Blank	2	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING FOUR PAYMENT FIELDS)
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1, of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1, of the Payer/Transmitter "A" Record.
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position 22, Sector 1, of the Payer/Transmitter "A" Record.
72-111	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided can be entered in

RECORD NAME: PAYEE "B" RECORD (USING FOUR PAYMENT FIELDS)—Continued
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			this field. The name of the other payees may be entered in the Second Payee Name Line field.
12-128	Blank	17	REQUIRED. Enter blanks.
SECTOR 2			
	Record Sequence	1	REQUIRED. Must be"2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.
123-128	Blank	6	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.

RECORD NAME: PAYEE "B" RECORD (USING FOUR PAYMENT FIELDS)—Continued
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
3-85	Blank	83	REQUIRED. Enter blanks.
86	Date of Sale Indicator	1	REQUIRED *FOR FORM 1099-B ONLY*. Enter appropriate indicator from table below: *Indicator* — *Usage* S — Date of Sale is the actual settlement date blank — Date of Sale is the trade date or this is an aggregate transaction
87-92	Date of Sale	6	REQUIRED *FOR FORM 1099-B ONLY*. Enter the trade date or the actual settlement date of the transaction in the format MMDDYY. Enter blanks if this is an aggregate transaction. DO NOT ENTER HYPHENS OR SLASHES.
93-100	CUSIP No.	8	REQUIRED *FOR FORM 1099-B ONLY*. Enter the CUSIP (Committee on Uniform Security Identification Procedures) number of the items reported for Amount Indicator "2" (Stocks, bonds, etc.). Enter blanks if this is an aggregate transaction. Enter "0" (zeroes) if the number is not available. For CUSIP numbers with more than 8 characters, supply the *first* 8.
101-126	Description	26	REQUIRED *FOR FORM 1099-B ONLY*. Enter a brief description of the item or services for which the proceeds are being reported. If fewer than 26 characters are required, left justify and fill unused positions with blanks. For regulated futures contracts, enter the customer account number. Enter blanks if this is an aggregate transaction.
127-128	Blank	2	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING FIVE PAYMENT FIELDS)
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1, of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1, of the Payer/Transmitter "A" Record.
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position 22, Sector 1, of the Payer/Transmitter "A" Record.

RECORD NAME: PAYEE "B" RECORD (USING FOUR PAYMENT FIELDS)—Continued
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
72-81	Payment Amount 5	10	This amount is identified by the amount indicator in position 23, Sector 1, of the Payer/Transmitter "A" Record.
82-121	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
122-128	Blank	7	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be ued for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left jus-

RECORD NAME: PAYEE "B" RECORD (USING FIVE PAYMENT FIELDS)—Continued
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
			tify and fill the unused positions with blanks. Use this field for the ZIP Code only.
123-128	Blank	6	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-85	Blank	83	REQUIRED. Enter blanks.
86	Date of Sale Indicator	1	REQUIRED *FOR FORM 1099-B ONLY*. Enter appropriate indicator from table below: *Indicator* — *Usage* S — Date of Sale is the actual settlement date blank — Date of Sale is the trade date or this is an aggregate transaction
87-92	Date of Sale	6	REQUIRED *FOR FORM 1099-B ONLY*. Enter the trade date or the actual settlement date of the transaction in the format MMDDYY. Enter blanks if this is an aggregate transaction. DO NOT ENTER HYPHENS OR SLASHES.
93-100	CUSIP No.	8	REQUIRED *FOR FORM 1099-B ONLY*. Enter the CUSIP (Committee on Uniform Security Identification Procedures) number of the items reported for Amount Indicator "2" (Stocks, bonds, etc.). Enter blanks if this is an aggregate transaction. Enter "0" (zeroes) if the number is not available. For CUSIP numbers with more than 8 characters, supply the *first* 8.
101-126	Description	26	REQUIRED *FOR FORM 1099-B ONLY*. Enter a brief description of the item or services for which the proceeds are being reported. If fewer than 26 characters are required, left justify and fill unused positions with blanks. For regulated futures contracts, enter the customer account number. Enter blanks if this is an aggregate transaction.
127-128	Blank	2	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING SIX PAYMENT FIELDS)—Continued
FORM 1099-B

skette sition	Field Title	Length	Description and Remarks
ECTOR 1 (Continued)			
-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1 of the Payer/Transmitter "A" Record.
2-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1 of the Payer/Transmitter "A" Record.
2-71	Payment Amount 4	10	This amount is identified by the amount indicator in position 22, Sector 1 of the Payer/Transmitter "A" Record.
2-81	Payment Amount 5	10	This amount is identified by the amount indicator in position 23, Sector 1 of the Payer/Transmitter "A" Record.
2-91	Payment Amount 6	10	This amount is identified by the amount indicator in position 24, Sector 1 of the Payer/Transmitter "A" Record.
2-128	Blank	37	REQUIRED. Enter blanks.
ECTOR 2			
	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter address information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
43-82	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
83-122	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
123-128	Blank	6	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING SIX PAYMENT FIELDS)—Continued
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be a "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-31	Payee City	40	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
32-33	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
34-42	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.
43-85	Blank	43	REQUIRED. Enter blanks.
86	Date of Sale Indicator	1	REQUIRED *FOR FORM 1099-B ONLY*. Enter appropriate indicator from table below: *Indicator* — *Usage* S — Date of Sale is the actual settlement date blank — Date of Sale is the trade date or this is an aggregate transaction
87-92	Date of Sale	6	REQUIRED *FOR FORM 1099-B ONLY*. Enter the trade date or the actual settlement date of the transaction in the format MMDDYY. Enter blanks if this is an aggregate transaction. DO NOT ENTER HYPHENS OR SLASHES.
93-100	CUSIP No.	8	REQUIRED *FOR FORM 1099-B ONLY*. Enter the CUSIP (Committee on Uniform Security Identification Procedures) number of the items reported for Amount Indicator "2" (Stocks, bonds, etc.). Enter blanks if this is an aggregate transaction. Enter "0" (zeroes) if the number is not available. For CUSIP numbers with more than 8 characters, supply the *first* 8.
101-126	Description	26	REQUIRED FOR FORM 1099-B ONLY. Enter a brief description of the item or services for which the proceeds are being reported. If fewer than 26 characters are required, left justify and fill unused positions with blanks. For regulated futures contracts, enter the customer account number. Enter blanks if this is an aggregate transaction.
127-128	Blank	2	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING SEVEN PAYMENT FIELDS)
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1 of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1 of the Payer/Transmitter "A" Record.
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position 22, Section 1 of the Payer/Transmitter "A" Record.
72-81	Payment Amount 5	10	This amount is identified by the amount indicator in position 23, Sector 1 of the Payer/Transmitter "A" Record.
82-91	Payment Amount 6	10	This amount is identified by the amount indicator in position 24, Sector 1 of the Payer/Transmitter "A" Record.
92-101	Payment Amount 7	10	This amount is identified by the amount indicator in position 25, Sector 1 of the Payer/Transmitter "A" Record.
102-128	Blank	27	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	First payee Name Line	40	REQUIRED. The First Payee Name line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
43-82	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
83-122	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.

RECORD NAME: PAYEE "B" RECORD (USING SEVEN PAYMENT FIELDS)—Continued
FORM 1099-B

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
123-128	Blank	6	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be a "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-31	Payee City	40	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
32-33	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
34-42	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.
43-85	Blank	43	REQUIRED. Enter blanks.
86	Date of Sale Indicator	1	REQUIRED *FOR FORM 1099-B ONLY*. Enter appropriate indicator from table below: *Indicator* — *Usage* S — Date of Sale is the actual settlement date blank — Date of Sale is the trade date or this is an aggregate transaction
87-92	Date of Sale	6	REQUIRED *FOR FORM 1099-B ONLY*. Enter the trade date or the actual settlement date of the transaction in the format MMDDYY. Enter blanks if this is an aggregate transaction. DO NOT ENTER HYPHENS OR SLASHES.
93-100	CUSIP No.	8	REQUIRED *FOR FORM 1099-B ONLY*. Enter the CUSIP (Committee on Uniform Security Identification Procedures) number of the items reported for Amount Indicator "2" (Stocks, bonds, etc.). Enter blanks if this is an aggregate transaction. Enter "0" (zeroes) if the number is not available. For CUSIP numbers with more than 8 characters, supply the *first* 8.
101-126	Description	26	REQUIRED *FOR FORM 1099-B ONLY*. Enter a brief description of the item or services for which the proceeds are being reported. If fewer than 26 characters are required, left justify and fill unused positions with blanks. For regulated futures contracts, enter the customer account number. Enter blanks if this is an aggregate transaction.

RECORD NAME: PAYEE "B" RECORD (USING SEVEN PAYMENT FIELDS)—Continued
FORM 1099-B

kette ition	Field Title	Length	Description and Remarks
CTOR 3 (Continued)			
-128	Blank	2	REQUIRED. Enter blanks.

PAYEE "B" RECORD—RECORD LAYOUT (USING ONE PAYMENT AMOUNT FIELD)
FORM 1099-B

ctor 1

RECORD EQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3-4	5	6-7	8—11	12	13—21

ctor 1 (Continued)

PAYERS' CCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	BLANK
22—31	32—41	42—81	82—121	122—128

ctor 2

RECORD EQUENCE	RECORD TYPE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK
1	2	3—42	43—71	72—73	74—82	83—85

ctor 2 (Continued)

DATE OF SALE INDICATOR	DATE OF SALE	CUSIP NO.	DESCRIPTION	BLANK
86	87—92	93—100	101—126	127—128

PAYEE "B" RECORD—RECORD LAYOUT (USING TWO PAYMENT AMOUNT FIELDS)
FORM 1099-B

ctor 1

RECORD EQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

ctor 1 (Continued)

PAYERS' CCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—41	52—91	92—128

PAYEE "B" RECORD—RECORD LAYOUT (USING TWO PAYMENT AMOUNT FIELDS)—Continued

FORM 1099-B

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK
1	2	3—42	43—82	83—111	112—113	114—122	123—128

Sector 3

RECORD SEQUENCE	RECORD TYPE	BLANK	DATE OF SALE INDICATOR	DATE OF SALE	CUSIP NO.	DESCRIPTION	BLANK
1	2	3—85	86	87—92	93—100	101—126	127—128

PAYEE "B" RECORD—RECORD LAYOUT (USING THREE PAYMENT AMOUNT FIELDS)

FORM 1099-B

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYERS' ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—61	62—101	102—128

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK
1	2	3—42	43—82	83—111	112—113	114—122	123—128

Sector 3

RECORD SEQUENCE	RECORD TYPE	BLANK	DATE OF SALE INDICATOR	DATE OF SALE	CUSIP NO.	DESCRIPTION	BLANK
1	2	3—85	86	87—92	93—100	101—126	127—128

PAYEE "B" RECORD—RECORD LAYOUT (USING FOUR PAYMENT AMOUNT FIELDS)

FORM 1099-B

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

PAYEE "B" RECORD—RECORD LAYOUT (USING FOUR PAYMENT AMOUNT FIELDS)—Continued
FORM 1099-B

Sector 1 (Continued)

PAYERS' ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—61	62—71	72—111	112—128

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK
1	2	3—42	43—82	83—111	112—113	114—122	123—128

Sector 3

RECORD SEQUENCE	RECORD TYPE	BLANK	DATE OF SALE INDICATOR	DATE OF SALE	CUSIP NO.	DESCRIPTION	BLANK
1	2	3—85	86	87—92	93—100	101—126	127—128

PAYEE "B" RECORD—RECORD LAYOUT (USING FIVE PAYMENT AMOUNT FIELDS)
FORM 1099-B

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYERS' ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	PAYMENT AMOUNT 5	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—61	62—71	72—81	82—121	122—128

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK
1	2	3—42	43—82	83—111	112—113	114—122	123—128

Sector 3

RECORD SEQUENCE	RECORD TYPE	BLANK	DATE OF SALE INDICATOR	DATE OF SALE	CUSIP NO.	DESCRIPTION	BLANK
1	2	3—85	86	87—92	93—100	101—126	127—128

PAYEE "B" RECORD—RECORD LAYOUT (USING SIX PAYMENT AMOUNT FIELDS)
FORM 1099-B

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYERS' ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	PAYMENT AMOUNT 5	PAYMENT AMOUNT 6	BLANK
22—31	32—41	42—51	52—61	62—71	72—81	82—91	92—128

Sector 2

RECORD SEQUENCE	RECORD TYPE	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	BLANK
1	2	3-42	43—82	83—122	123—128

Sector 3

RECORD SEQUENCE	RECORD TYPE	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK
1	2	3—31	32—33	34—42	43—85

Sector 3 (Continued)

DATE OF SALE INDICATOR	DATE OF SALE	CUSIP NO.	DESCRIPTION	BLANK
86	87—92	93—100	100—126	127—128

PAYEE "B" RECORD—RECORD LAYOUT (USING SEVEN PAYMENT AMOUNT FIELDS)
FORM 1099-B

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYERS' ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	PAYMENT AMOUNT 5	PAYMENT AMOUNT 6
22—31	32—41	42—51	52—61	62—71	72—81	82—91

PAYEE "B" RECORD—RECORD LAYOUT (USING SEVEN PAYMENT AMOUNT FIELDS)—Continued
FORM 1099-B

Sector 1 (Continued)

PAYMENT AMOUNT 7	BLANK
92—101	102—128

Sector 2

RECORD SEQUENCE	RECORD TYPE	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	BLANK
1	2	3—42	43—82	83—122	123—128

Sector 3

RECORD SEQUENCE	RECORD TYPE	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK
1	2	3—31	32—33	34—42	43—85

Sector 3 (Continued)

DATE OF SALE INDICATOR	DATE OF SALE	CUSIP NO.	DESCRIPTION	BLANK
86	87—92	93—100	101—126	127—128

SEC. 12. PAYEE "B" RECORDS—FIELD DESCRIPTIONS FOR FORM W-2G

.01 This section contains the general payment information from individual statements for Form W-2G. For detailed explanations of the W-2G fields, see W-3G, Transmittal of Certain Information Returns, which is available at local IRS offices.

.02 When reporting information for form W-2G, the Payee "B" Records must contain 3 sectors.

.03 FORM W-2G CANNOT BE FILED UNDER THE COMBINED FEDERAL/STATE FILING PROGRAM.

RECORD NAME: PAYEE "B" RECORD
FORM W-2G

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1			
1	Record Sequence	1	REQUIRED. Must be a "1". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-4	Payment Year	2	REQUIRED. Must be the last two digits of the year for which payments are being reported (e.g. if payments were made in 1985 enter "85"). Must be incremented each year.
5	Document Specific Code Type of Wager (Form W-2G only)	1	REQUIRED for W-2G. Use only for reporting the Type of Wager on *Form W-2G*.

RECORD NAME: PAYEE "B" RECORD—Continued
FORM W-2G

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			Category — *Code* Horse Race Track (or Off Track Betting of a Horse Track nature) — 1 Dog Race Track (or Off Track Betting of a Dog Track nature) — 2 Jai-alai — 3 State Conducted Lottery — 4 Keno — 5 Casino Type Bingo. DO NOT use this code for any other type of Bingo winnings (i.e. Church, Fire Dept. etc.). — 6 Slot Machines — 7 Any other types of gambling winnings. This includes Church Bingo, Fire Dept. Bingo, unlabeled winnings, etc. — 8
6-7	Blank	2	REQUIRED. Enter blanks. (Reserved for IRS use). Diskette position 6 is used to indicate a corrected return. Refer to Part A, Sec. 10 for specific instructions on how to file corrected returns utilizing either magnetic media or paper forms.
8-11	Name Control	4	REQUIRED. Enter the first 4 letters of the surname of the payee. Surnames of less than four (4) letters should be left justified, filling the unused positions with blanks. Special characters and imbedded blanks should be removed. IF THE NAME CONTROL IS NOT DETERMINABLE BY THE PAYER, LEAVE THIS FIELD BLANK. A dash (–) or ampersand (&) are the only acceptable special characters.
12	Type of TIN	1	REQUIRED. This field is used to identify the Taxpayer Identification Number (TIN) in positions 13-21 as either an Employer Identification Number, a Social Security Number, or the reason no number is shown. Enter the appropriate code from the table below: *Type of TIN* — *TIN* — *Type of Account* 1 — EIN — A business or an organization 2 — SSN — An individual 9 — SSN — The payee is a foreign individual and not a U.S. resident. blank — N/A — A Taxpayer Identification Number is required but unobtainable due to legitimate cause; e.g. number applied for but not received.
13-21	Taxpayer Identification Number	9	REQUIRED. Enter the valid 9-digit Taxpayer Identification Number of the payee (SSN or EIN, as appropriate). When an identification number has been applied for but not received or when there is any other legitimate cause for not having an identification number, *enter blanks*. *DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROS*. Any record containing an invalid identification number in this field will be returned for correction.

RECORD NAME: PAYEE "B" RECORD—Continued
FORM W-2G

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
22-31	Payer's Account Number for Payee	10	REQUIRED. Payer may use this field to enter the payee's account number. The use of this item will facilitate easy reference to specific records in the payer's file should any questions arise. DO NOT ENTER A TAXPAYER IDENTIFICATION NUMBER IN THIS FIELD. Enter blanks if the Payer's Account Number for Payee is not to be entered in this field. An account number can be any account number assigned by the payer to the payee (i.e., checking account, savings account, etc.). THIS NUMBER WILL HELP TO DISTINGUISH THE INDIVIDUAL PAYEE'S ACCOUNT WITH YOU AND THE SPECIFIC TRANSACTION MADE WITH THE ORGANIZATION, SHOULD MULTIPLE RETURNS BE FILED. This information will be particularly necessary if you need to file a corrected return. You are strongly encouraged to use this field. You may use any number that will help identify the particular transaction that you are reporting.
	Payment Amount Fields		The number of payment amounts is dependent on the number of Amount Indicators present in positions 19-27 of Sector 1 of the "A" Record. The First Payee Name Line *must* appear immediately after the last payment amount indicated as being used. For example, if you are reporting 1099-INT and you used only Amount Indicator "3" in the Payer/Transmitter "A" Record, then you will only use one ten position payment amount in the Payee "B" Record, right justified, and the First Payee Name Line will begin in position 42. Each payment field that you allow for, or use, must contain 10 numeric characters (see following NOTE). Do not provide a payment amount field when the corresponding Amount Indicator in the Payer/Transmitter "A" Record is blank. Each payment amount must be entered in dollars and cents. Do not enter dollar signs, commas, decimal points, or *NEGATIVE PAYMENTS* (except those items that reflect a loss on Form 1099-B and must be negative overpunched in the units position). Example: If the Amount Indicators are reflected as "123bbbbbb", the Payee "B" Records must have only 3 payment amount fields. If Amount Indicators are reflected as "12367bbbb", the "B" Records must have only 5 payment amount fields. Payment amounts MUST be right-justified and unused portions MUST be zero-filled. NOTE 1: If any one payment amount exceeds "9999999999" (dollars and cents), as many SEPARATE Payee "B" Records as necessary to contain the total amount MUST be submitted for the Payee. NOTE 2: If you file 1099-MISC and use Amount Code "8" in the Amount Indicator field of the Payer/Transmitter "A" Record, you must enter 0000000100 in the corresponding Payment Amount Field. This will not represent an actual money amount; this is an amount *code*. (Refer to Part B., Sec. 3, NOTE 1, of the Amount Indicators, Form 1099-MISC, for clarification.)
32-41	Payment Amount 1	10	REQUIRED. This amount is identified by the indicator in position 19 of Sector 1 of the Payer/Transmitter "A" Record. *This amount must always be present.*

Determine at this point the number of payment fields to be reported within the Payee "B" Record. This can be determined from the number of Amount Indicators appearing in positions 19-27 of Sector 1 of the Payer/Transmitter "A" Record. Following are the formats for completing positions 42-128 of SECTOR 1, positions

RECORD NAME: PAYEE "B" RECORD—Continued
FORM W-2G

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
	1-128 of SECTOR 2 and positions 1-128 of SECTOR 3 of the Payee "B" Record. ***WHEN REPORTING INFORMATION FOR FORM W-2G THREE SECTORS MUST BE USED TO MAKE UP A PAYEE "B" RECORD.*** Use the appropriate format as required.		
42-81	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear immediately after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 above. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, only the name of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
82-121	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 above. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
122-128	Blank	7	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
43-71	Payee City	29	REQUIRED. Enter the city, left justify and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.
72-73	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
74-82	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.

RECORD NAME: PAYEE "B" RECORD (USING ONE PAYMENT FIELD—Continued
FORM W-2G

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
83-128	Blank	46	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be a "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-60	Blank	57	REQUIRED. Enter blanks.
61-66	Date Won	6	REQUIRED *FOR FORM W-2G ONLY*. Enter the date of the winning event in MMDDYY format. This is not the date the money was paid, if paid after the date of the race (or game). DO NOT ENTER HYPHENS OR SLASHES.
67-81	Transaction	15	REQUIRED *FOR FORM W-2G ONLY*. The ticket number, card number (and color, if applicable), machine serial number or any other information that will help identify the winning transaction.
82-86	Race	5	REQUIRED *FOR FORM W-2G ONLY*. The race (or game) applicable to the winning ticket.
87-91	Cashier	5	REQUIRED *FOR FORM W-2G ONLY*. The initials of the cashier and/or the window number making the winning payment.
92-96	Window	5	REQUIRED *FOR FORM W-2G ONLY*. The location of the person paying the winnings.
97-111	First ID	15	REQUIRED *FOR FORM W-2G ONLY*. The first identification number of the person receiving the winnings.
112-126	Second ID	15	REQUIRED *FOR FORM W-2G ONLY*. The second identification number of the person receiving the winnings.
127-128	Blank	2	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)
FORM W-2G

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified as the amount indicator in position 20, Sector 1, of the Payer/Transmitter "A" Record.
52-91	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 of Sector 1. If

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)—Continued
FORM W-2G

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
92-128	Blank	37	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequenced	1	REQUIRED. Must be "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.
123-128	Blank	6	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)—Continued
FORM W-2G

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-60	Blank	58	REQUIRED. Enter blanks.
61-66	Date Won	6	REQUIRED *FOR FORM W-2G ONLY*. Enter the date of the winning event in MMDDYY format. This is not the date the money was paid, if paid after the date of the race (or game). DO NOT ENTER HYPHENS OR SLASHES.
67-81	Transaction	15	REQUIRED *FOR FORM W-2G ONLY*. The ticket number, card number (and color, if applicable), machine serial number or any other information that will help identify the winning transaction.
82-86	Race	5	REQUIRED *FOR FORM W-2G ONLY*. The race (or game) applicable to the winning ticket.
87-91	Cashier	5	REQUIRED *FOR FORM W-2G ONLY*. The initials of the cashier and/or the window number making the winning payment.
92-96	Window	5	REQUIRED *FOR FORM W-2G ONLY*. The location of the person paying the winnings.
97-111	First Id	15	REQUIRED *FOR FORM W-2G ONLY*. The first identification number of the person receiving the winnings.
112-126	Second ID	15	REQUIRED *FOR FORM W-2G ONLY*. The second identification number of the person receiving the winnings.
127-128	Blank	2	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)
FORM W-2G

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1 of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1 of the Payer/Transmitter "A" Record.
62-101	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose taxpayer idientification number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused po-

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)—Continued
FORM W-2G

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			sitions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided can be entered in this field. The names of the other payees may be entered in the Second Payee Name Line field.
102-128	Blank	27	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees' this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.
123-128	Blank	6	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be "3". Used to sequence the sectors making up a Service PAYEE Record.

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)—Continued
FORM W-2G

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-60	Blank	58	REQUIRED. Enter blanks.
61-66	Date Won	6	REQUIRED *FOR FORM W-2G ONLY*. Enter the date of the winning event in MMDDYY format. This is not the date the money was paid, if paid after the date of the race (or game). DO NOT ENTER HYPHENS OR SLASHES.
67-81	Transaction	15	REQUIRED *FOR FORM W-2G ONLY*. The ticket number, card number (and color, if applicable), machine serial number or any other information that will help identify the winning transaction.
82-86	Race	5	REQUIRED *FOR FORM W-2G ONLY*. The race (or game) applicable to the winning ticket.
87-91	Cashier	5	REQUIRED *FOR FORM W-2G ONLY*. The initials of the cashier and/or the window number making the winning payment.
92-96	Window	5	REQUIRED *FOR FORM W-2G ONLY*. The location of the person paying the winnings.
97-111	First ID	15	REQUIRED *FOR FORM W-2G ONLY*. The first identification number of the person receiving the winnings.
112-126	Second ID	15	REQUIRED *FOR FORM W-2G ONLY*. The second identification number of the person receiving the winnings.
127-128	Blank	2	REQUIRED. Enter blanks.

SEC. 13. PAYEE "B" RECORD—RECORD LAYOUTS FOR FORM W-2G

PAYEE "B" RECORD—RECORD LAYOUT (USING ONE PAYMENT AMOUNT FIELD)
Form W-2G

SECTOR 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3-4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYERS' ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	BLANK
22—31	32—41	42—81	82—121	122—128

PAYEE "B" RECORD—RECORD LAYOUT (USING ONE PAYMENT AMOUNT FIELD)—Continued
FORM W-2G

Sector 2

RECORD SEQUENCE	RECORD TYPE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK
1	2	3—42	43—71	72—73	74—82	83—85

Sector 3

RECORD SEQUENCE	RECORD TYPE	BLANK	DATE WON	TRANSACTION	RACE	CASHIER
1	2	3—60	61—66	67—81	82—86	87—91

Sector 3 (Continued)

WINDOW	FIRST ID	SECOND ID	BLANK
92—96	97—111	112—126	127—128

PAYEE "B" RECORD—RECORD LAYOUT (USING TWO PAYMENT AMOUNT FIELDS)
Form W-2G

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYERS' ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—91	92—128

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK
1	2	3—42	43—82	83—111	112—113	114—122	123—128

Sector 3

RECORD SEQUENCE	RECORD TYPE	BLANK	DATE WON	TRANSACTION	RACE	CASHIER
1	2	3—60	61—66	67—81	82—86	87—91

PAYEE "B" RECORD—RECORD LAYOUT (USING TWO PAYMENT AMOUNT FIELDS)—Continued
FORM W-2G

Sector 3 (Continued)

WINDOW	FIRST ID	SECOND ID	BLANK
92—96	97—111	112—126	127—128

PAYEE "B" RECORD—RECORD LAYOUT (USING THREE PAYMENT AMOUNT FIELDS)
Form W-2G

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYERS' ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—61	62—101	102-128

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK
1	2	3—42	43—82	83—111	112—113	114—122	123—128

Sector 3

RECORD SEQUENCE	RECORD TYPE	BLANK	DATE WON	TRANSACTION	RACE	CASHIER
1	2	3—60	61—66	67—81	82—86	87—91

Sector 3 (Continued)

WINDOW	FIRST ID	SECOND ID	BLANK
92—96	97—111	112—126	127—128

SEC. 14. END OF PAYER "C" RECORD

.01 The Control Total fields have been expanded from 12 to 15 positions. Adjust your programs accordingly.

.02 Write this record after the last payee "B" Record following the last Payer/Transmitter "A" Record. A diskette will contain more than one (1) End of Payer "C" Record if the last Payee "B" Record for more than one payer is reported on the same diskette.

.03 Each End of Payer "C" Record must contain a count of the number of Payee "B" Records immediately preceding the End of Payer "C" Record

and following the preceding Payer/Transmitter "A" Record under which a Payer is reporting payments for a type of return. To illustrate:

(a) Single diskette; where all the records of a Payer for a particular type of return are reported on a single diskette, the last preceding Payer/Transmitter "A" Record would be the "A" Record immediately preceding the Payer's Payee "B" Records for which the End of Payer "C" Record has been written.

(b) Multiple diskette; where the reporting of a Payer for a particular type of return begins on one diskette and ends on another diskette, the last preceding Payer/Transmitter "A" Record would immediately precede all the Payee "B" Records on the diskette for which the Payer "C" Record has been written.

.04 Payers/Transmitters must verify the accuracy of the totals in the "C" Record and must enter the totals on the transmittal, Form 4804, which will accompany the shipment.

.05 The End of Payer "C" Record must be followed by a State Totals "K" Record (if any), or new Payer/Transmitter "A" Record for the next Payer (if any), or an End of Transmission "F" Record.

RECORD NAME: END OF PAYER "C" RECORD

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1			
1	Record Sequence	1	REQUIRED. Enter "1". Must be the first character of each END OF PAYER RECORD.
2	Record Type	1	REQUIRED. Enter "C".
3-8	Number of Payees	6	REQUIRED. Enter the total number of payees ("B" Records) covered by the preceding Payer/Transmitter "A" Record. Right justify and zero fill.
9-23	Control Total 1	15	REQUIRED. Please note that all Control Total fields have been expanded from 12 to 15 positions. Enter accumulated totals from payment Amount 1. Right justify and zero fill. IF LESS THAN NINE AMOUNT FIELDS ARE BEING REPORTED, ZERO FILL UNUSED CONTROL TOTAL FIELDS.
	Control Total 2 through Control Total 9 are OPTIONAL. If any corresponding Payment Amount Fields are present in the Payee "B" Records, accumulate into the appropriate Control Total field. ZERO FILL UNUSED CONTROL TOTAL FIELDS. Please note that all Control Total fields have been expanded from 12 to 15 positions.		
24-38	Control Total 2	15	
39-53	Control Total 3	15	
54-68	Control Total 4	15	
69-83	Control Total 5	15	
84-98	Control total 6	15	
99-113	Control Total 7	15	
114-128	Control Total 8	15	
Sector 2 is only applicable in the End of Payer "C" Record if you use more than eight payment amount fields.			
SECTOR 2			
1	Record Sequence	1	REQUIRED. Enter "2".
2	Record Type	1	REQUIRED. Enter "C".
3-17	Control Total 9	15	REQUIRED. Enter accumulated totals from Payment Amount 9. Right justify and zero fill.
18-128	Blank	111	REQUIRED. Enter blanks.

SEC. 15. END OF PAYER "C" RECORD—RECORD LAYOUT

SECTOR 1 (Please note that all Control Total fields have been expanded from 12 to 15 positions.)

RECORD SEQUENCE	RECORD TYPE	NUMBER OF PAYEES	CONTROL TOTAL 1	CONTROL TOTAL 2	CONTROL TOTAL 3	CONTROL TOTAL 4
1	2	3—8	9—23	24—38	39—53	54-68

CONTROL TOTAL 5	CONTROL TOTAL 6	CONTROL TOTAL 7	CONTROL TOTAL 8
69—83	84—98	99—113	114—128

SECTOR 2

RECORD SEQUENCE	RECORD TYPE	CONTROL TOTAL 9	BLANK
1	2	3—17	18—128

SEC. 16. STATE TOTALS "K" RECORD

.01 The Control Total fields have been expanded from 12 to 15 positions. Adjust your programs accordingly.

.02 The State Totals "K" Record is a summary for a given payer and a given state in the Combined Federal/State Filing Program, used only when State Reporting approval has been granted.

.03 The "K" Record will contain the totals of the payment amount fields and the total number of payees filed by a given payer for a given state. The "K" Record(s) must be written after the "C" Record for the related "A" Record.

.04 There MUST be a separate "K" Record for each state being reported.

.05 Refer to Part A, Sec. 14 for the requirements and conditions that *MUST* be met to file on this Program.

RECORD NAME: STATE TOTALS "K" RECORD

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1			
1	Record Sequence	1	REQUIRED. Enter "1". Must be the first character for each STATE TOTALS "K" RECORD.
2	Record Type	1	REQUIRED. Enter "K".
3-8	Number of Payees	6	REQUIRED. Enter the number of payees (different TINs) being reported to this state. Right justify and zero fill.
9-23	Control Total 1	15	REQUIRED. Please note that all Control Total fields have been expanded from 12 to 15 positions. Enter accumulated totals from Payment Amount 1. Right justify and zero fill. IF LESS THAN NINE AMOUNT FIELDS ARE BEING REPORTED, ZERO FILL UNUSED CONTROL TOTAL FIELDS.
	Control Total 2 through Control Total 9 are OPTIONAL. If any corresponding payment Amount fields are present in the Payee "B" Records, accumulate into the appropriate Control Total field. ZERO FILL UNUSED CONTROL TOTAL FIELDS. Please note that all Control Total fields have been expanded from 12 to 15 positions.		
24-38	Control Total 2	15	
39-53	Control Total 3	15	
54-68	Control Total 4	15	
69-83	Control Total 5	15	

RECORD NAME: STATE TOTALS "K" RECORD—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
84-98	Control Total 6	15	
99-113	Control Total 7	15	
114-128	Control Total 8	15	
SECTOR 2			
1	Record Sequence	1	REQUIRED. Enter "2".
2	Record Type	1	REQUIRED. Enter "K".
3-17	Control Total 9	15	REQUIRED. Enter accumulated totals from payment Amount 9. Right justify and zero fill. Use blanks if you have less than nine payment amount fields.
18-126	Blank	109	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. Enter the code for the state to receive the information.

SEC. 17. STATE TOTALS "K" RECORD—RECORD LAYOUT

SECTOR 1 (Please note that all Control Total fields have been expanded from 12 to 15 positions.)

RECORD SEQUENCE	RECORD TYPE	NUMBER OF PAYEES	CONTROL TOTAL 1	CONTROL TOTAL 2	CONTROL TOTAL 3	CONTROL TOTAL 4
1	2	3—8	9—23	24—38	39—53	54—68

CONTROL TOTAL 5	CONTROL TOTAL 6	CONTROL TOTAL 7	CONTROL TOTAL 8
69—83	84—98	99—113	114—128

SECTOR 2

RECORD SEQUENCE	RECORD TYPE	CONTROL TOTAL 9	BLANK	STATE CODE
1	2	3—17	19—126	127—128

SEC. 18. END OF TRANSMISSION "F" RECORD

.01 The "F" Record is a summary of the number of payers and diskettes in the entire file.

.02 This record should be written after the last "C" Record (or "K" Record, when applicable).

.03 Only a Tape Mark or a Tape Mark and Trailer label may follow the "F" Record.

END OF TRANSMISSION "F" RECORD

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
1	Record Type	1	REQUIRED. Enter "F". Must be first character of END OF TRANSMISSION RECORD.

END OF TRANSMISSION "F" RECORD—Continued

Diskette Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
2-5	Number of Payers	4	Enter total number of payers for this transmission. Right justify and zero fill.
6-8	Number of Diskettes	3	Enter total number of diskettes in this transmission. right justify and zero fill.
9-30	Zero	22	REQUIRED. Enter zeroes.
31-128	Blank	98	REQUIRED. Enter blanks.

SEC. 19. END OF TRANSMISSION "F" RECORD—RECORD LAYOUT
END OF TRANSMISSION "F" RECORD—RECORD LAYOUT

RECORD TYPE	NUMBER OF PAYERS	NUMBER OF DISKETTES	ZERO	BLANK
1	2—5	6—8	9—30	31—128

26 CFR 601.602: Tax forms and instructions.

Rev. Proc. 85-48

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PART D. BURROUGHS SUPER MINI-DISK II SPECIFICATIONS

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NOTE: THIS REVENUE PROCEDURE MAY ONLY BE USED TO PREPARE CASSETTE OR MINI-DISK SUBMISSIONS FOR TAX YEAR 1985. UPDATED COPIES ARE PUBLISHED EACH YEAR. PLEASE READ THIS PUBLICATION CAREFULLY; **YOU MAY BE SUBJECT TO PENALTIES IF YOU FAIL TO FOLLOW THE INSTRUCTIONS IN THIS REVENUE PROCEDURE.** THESE INCLUDE PENALTIES OF $50 PER DOCUMENT FOR EACH DOCUMENT SUBMITTED WITHOUT A TAXPAYER IDENTIFICATION NUMBER (TIN) OR WITH AN INCORRECT TIN, AND FOR EACH DOCUMENT NOT SUBMITTED ON MAGNETIC MEDIA IF YOU ARE REQUIRED TO FILE THIS WAY. THE MAXIMUM PENALTY IS $50,000 (PAYERS OF INTEREST AND DIVIDENDS ARE NOT SUBJECT TO THIS MAXIMUM.)

PART A.—GENERAL

SECTION 1. PURPOSE

.01 The purpose of this revenue procedure is to provide the requirements and conditions for filing information return Forms 1098, 1099, 5498, and W-2G on cassette or mini-disk. *THIS REVENUE PROCEDURE IS TO BE USED FOR THE PREPARATION OF TAX YEAR 1985 INFORMATION RETURNS ONLY.* THIS PROCEDURE IS UPDATED YEARLY TO REFLECT NECESSARY CHANGES. PLEASE READ THIS PUBLICATION CAREFULLY. Specifications for filing the following forms are contained in this procedure:

(a) Form 1098, Mortgage Interest Statement.

(b) Form 1099-A, Information Return for Acquisition or Abandonment of Secured Property. (For Mini-Disk only.)

(c) Form 1099-B, Statement for Recipients of Proceeds from Broker and Barter Exchange Transactions. (For Mini-Disk only.)

(d) Form 1099-DIV, Statement for Recipients of Dividends and Distributions.

(e) Form 1099-G, Statement for Recipients of Certain Government Payments.

(f) Form 1099-INT, Statement for Recipients of Interest Income.

(g) Form 1099-MISC, Statement for Recipients of Miscellaneous Income.

(h) Form 1099-OID, Statement for Recipients of Original Issue Discount.

(i) Form 1099-PATR, Statement for Recipients (Patrons) of Taxable Distributions Received From Cooperatives.

(j) Form 1099-R, Statement for Recipients of Total Distributions from Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, Etc.

(k) Form 5498, Individual Retirement Arrangement Information.

(l) Form W-2G, Statement for Recipients of Certain Gambling Winnings. (For Mini-Disk only.)

.02 This procedure also provides the requirements and specifications for mini-disk filing under the Combined Federal/State Filing Program. Refer to Part A, Sec. 14. Cassette filers may not participate in this program due to the requirement that records on this program must be 360 characters in length. Cassette records cannot exceed 256 characters.

.03 The following revenue procedures and publications provide more detailed filing procedures for certain information returns, payer identification, transfer agents and paper substitute specifications, respectively.

(a) 1985 "Instructions for Form 1099 Series, 1098, 5498, and 1096," provide further information on filing returns with the Internal Revenue Service (IRS). These instructions are available at local IRS offices.

(b) Rev. Proc. 84-24, 1984-1 C.B. 465, regarding preparation of transmittal documents for information returns.

(c) Rev. Proc. 84-33, 1984-1 C.B. 502, regarding the optional method for agents to report and deposit backup withholding.

(d) Publication 1179, Requirements for Reproducing Paper Substitutes of Forms 1096, 1099 series, 5498, W-2G and W-3G. A supplement will be issued to include instructions for substitutes of Form 1098, Mortgage Interest Statement.

.04 This procedure supersedes the following revenue procedure: Rev. Proc. 84-65, 1984-2 C.B. 553, also published in Publication 1253 Rev. (9-84), Requirements and Conditions for Filing Information Returns in the Forms 1099, 5498, and W-2G Series on Cassette or Mini-Disk.

.05 Refer to Part A, Sec. 15 for definitions of terms used in this publication.

SEC. 2. BACKGROUND—PRIOR YEAR CHANGES (TAX YEAR 1984)

.01 This section contains a *review* of the changes described in the revenue procedure last year. *Please* insure that the necessary reprogramming was accomplished in order to comply with last year's changes as these changes will still be necessary in the program for the current year.

.02 The following were general changes.

(a) Procedures for applying for waivers for undue hardship were added.

(b) An explanation of penalties was added.

(c) Reports from different branches for one payer were consolidated under one Payer/Transmitter "A" Record for each type of information return. For example, all like Form 1099-INT documents must be sorted together under

one Payer/Transmitter "A" Record, followed by the appropriate Payee "B" Records and one End of Payer "C" Record.

(d) The explanation of Taxpayer Identification Numbers (TINs) was rewritten to clarify changes concerning backup withholding and due diligence requirements.

(e) Changes were made to the requirements concerning the paper copy of the information return furnished to the payee.

(f) A definition for "Transfer Agent" was added.

(g) A list of valid U.S. Postal Service State Abbreviations was added to aid in developing the State Code portion of Name Line fields.

.03 The following changes were made to the Payer/Transmitter "A" Record.

(a) Header label UHL1 was added as one of the standard labels IRS programs can process.

(b) Amount Indicator "2" was added for Form 5498.

(c) "Type of Return" and "Amount Indicators" were added for Form W-2G for Mini-Disk filers.

(d) The codes for "Type of Payer" and "Payee 'B' Record Surname Indicator" fields should have been deleted from your programs. However, the positions in the record *should not* have been deleted. Fill these positions with blanks.

(e) The "Second Payer Name" field was shortened from 40 characters to 39 characters. The contents of the "Second Payer Name" field, as well as the contents of the "Payer Shipping Address" and the "Payer City, State and ZIP Code" fields, are dependent upon the value in the "Transfer Agent Indicator".

(f) A "Transfer Agent Indicator" was added following the "Second Payer Name" field. The contents of this field let IRS programs know if the information in "Second Payer Name", "Payer Shipping Address" and "Payer City, State and ZIP Code" pertains to the Payer or to the Transfer Agent.

(g) The name of "Payer Mailing Address" was changed to "Payer Shipping Address." Beginning with Tax Year 1984 returns, IRS notified payers of any information returns not containing valid TINs. This notification includes a payee notice for each such information return. Therefore, we must have an address capable of accepting volume mail.

.04 The following changes were made to the Payee "B" Record.

(a) The meaning of the "Document Specific Code" for Form 1099-G was expanded.

(b) The use of the "Document Specific Code" was increased to include Type of Wager for Form W-2G for Mini-Disk filers.

(c) PLEASE NOTE: If any one Payment Amount Field exceeds "9999999999" (dollars and cents), as many SEPARATE Payee "B" Records as necessary to contain the total MUST be submitted for the Payee. Example: the total money amount to be reported for Payee ABC is $250,371,491.87. Three Payee "B" Records will have to be submitted for Payee ABC to contain the entire total amount. (DO NOT enter dollar signs, commas, or decimal points, in the Payment Amount fields.)

SEC. 3. NATURE OF CHANGES—CURRENT YEAR (TAX YEAR 1985)

.01 DUE TO *NUMEROUS* LEGISLATIVE AND FORMS CHANGES BETWEEN TAX YEARS 1984 AND 1985, CHANGES HAVE *NOT* BEEN LISTED INDIVIDUALLY UNDER THIS SECTION. THIS ENTIRE PUBLICATION HAS BEEN REVISED. REVIEW THIS REVENUE PROCEDURE IN ITS *ENTIRETY*.

SEC. 4. WAGE AND PENSION INFORMATION FILED WITH SSA

.01 Section 8(b), Public Law 94-202, 1976-1 C.B. 503, enacted in January 1976, authorized the combined reporting of FICA detailed information in one consolidated annual W-2 (Copy A) to the Federal government. AS A RESULT, FORMS W-2 AND W-2P ARE TO BE FILED WITH THE SOCIAL SECURITY ADMINISTRATION (SSA), NOT WITH THE INTERNAL REVENUE SERVICE.

.02 SSA will accept magnetic media filing of Forms W-2 and W-2P and has issued the following concerning this: TIB-4a, "*Magnetic Tape Reporting*, Submitting FICA Wage and Tax Data to the Social Security Administration"; TIB-4b, "*Magnetic Tape Reporting*, Submitting Annuity, Pension, Retired Pay or IRA Payment to the Social Security Administration"; and TIB-4c, "*Diskette Reporting*, Submitting FICA Wage and Tax Data to the Social Security Administration". Applications for filing Forms W-2 and W-2P on magnetic media appear in TIBs-4a, 4b, and 4c.

.03 Copies of Social Security Administration publications TIB-4a, 4b, and 4c are available from any local Social Security Administration office or the SSA Regional Magnetic Media Coordinators.

SEC. 5. APPLICATION FOR MAGNETIC MEDIA REPORTING AND REQUESTS FOR UNDUE HARDSHIP WAIVERS

.01 For purposes of this revenue procedure, the *PAYER* is the organization making the payments and the *TRANSMITTER* is the organization preparing the cassette or Mini-Disk file. The payer and transmitter may be the same organization. Do not submit returns on cassette if you transmit for someone else due to the 256 character record restriction. Payers or their transmitters are required to complete Form 4419, Application for Magnetic Media Reporting of Information Returns. A copy of this form, for your use, can be found at the end of this publication. Requests for additional information or forms related to magnetic media processing should be addressed to the Magnetic Media Coordinator at the appropriate service center or the National Computer Center.

On January 1, 1985, the National Computer Center assumed responsibility for the magnetic media processing previously handled by the Philadelphia, Kansas City, and Austin Service Centers. Beginning January 1, 1986, magnetic media processing for *ALL* service centers will be centralized at the National Computer Center. Addresses are listed in Part A, Sec. 13 of this revenue procedure.

.02 Applications should be filed with the National Computer Center or the appropriate service center 90 days before the due date of the return. IRS will act on an application and notify the applicant, in writing, of authorization to file. A five character *Transmitter Control Code* will be assigned and included in an acknowledgement letter within 30 days of receipt of the application. Cassette or Mini-Disk returns may not be filed with IRS until the application has been approved. Do not enter blanks in the "A" Record Transmitter Control Code field; enter the five character Transmitter Control Code which is assigned to you by IRS after you have filed an application and it has been approved.

.03 After you have received approval to file on magnetic media, you do not need to reapply each year *UNLESS*:

(a) there are hardware or software changes that would affect the characteristics of the magnetic media submission (e.g., changing from cassette or Mini-Disk to tape filing or vice versa) or,

(b) you discontinue filing on magnetic media for a year (your five character Transmitter Control Code may be reassigned).

If either of these conditions applies to you, you should contact your coordinator for clarification. In *ALL* correspondence, refer to your current five character Transmitter Control Code to assist the coordinator in locating your files.

.04 IRS will assist new filers with their initial cassette or Mini-Disk submission by reviewing *"test"* files submitted in advance of the filing season. Approved payers or transmitters should submit *"test"* files with the Magnetic Media Coordinator at the appropriate service center or the National Computer Center. You *MUST* submit a *"test"* file in order to participate in the Combined Federal/State Program; however, you are encouraged to submit *"test"* files if you are a new filer on magnetic media. As a guideline, IRS prefers that all *"test"* files be submitted between September and December. Refer to Part A, Sec. 13 for addresses. Do not submit *"test"* cassettes or Mini-Disks after January 1. If you are unable to submit your *"test"* file by the end of December, you may *only* send a sample hardcopy printout or cassette or Mini-Disk dump to the National Computer Center which shows a sample of each record (A, B, C, K and F) *used*. Clearly mark the hardcopy printout or dump as "TEST DATA", and include identifying information such as name, address and telephone number of someone familiar with the *"test"* print or dump who may be contacted to discuss its acceptability. After January 1, 1986, submit the *"test"* print or dump showing a sample of each record to the National Computer Center only.

.05 If your magnetic media files have been prepared for you in the past by a service agency, and you now have computer equipment compatible with that of IRS and wish to prepare your own files, you must request your own five character Transmitter Control Code by filing an application, Form 4419, as described above.

.06 If you as an individual or orgnaization are an approved filer on magnetic media and you change your name or the name of your organization, please notify the National Computer Center or service center Magnetic Media Coordinator so that your file may be updated to reflect the proper name.

.07 In accordance with section 1.6041-7(b) of the Income Tax Regulations, payments to providers of medical and health care services from separate departments of a health care carrier may be reported as separate returns on magnetic media. In this case, the headquarters office will be considered to be the transmitter, and the individual departments of the company filing reports will be considered to be payers. A *single* application form covering *all* the departments which will be filing on cassette or mini-disk should be submitted. One five character Transmitter Control Code may be used for all departments.

.08 Section 1.6045-1(1) of the Income Tax Regulations requires brokers and barter exchanges to use magnetic media in reporting all Form 1099-B data to the IRS. Generally, *NEW* brokers and *NEW* barter exchanges may request an undue hardship exception by filing an application, by the end of the second month following the month in which they became a broker or barter exchange, with the National Computer Center or service center Magnetic Media Coordinator.

.09 *All* requests for undue hardship exemptions should be submitted at least 90 days before the due date of the return, except as stated in Sec. 5.08 above.

.10 The requirements to receive a waiver from filing *required* information returns on magnetic media for tax year 1985 are more stringent than they were for tax year 1984. Filers must submit a *written* statement requesting an undue hardship waiver from magnetic media filing for a specific period of time, not to exceed one tax year. If the filer requires a waiver for a longer period of time, the filer must reapply at the appropriate time each year (90 days before the due date of the return). Filers may not apply for a waiver for more than one tax year at a time. The written statement *must* contain the following identifying information:

(a) The filer's name and address.

(b) The filer's Taxpayer Identification Number (SSN or EIN).

(c) The period for which the waiver is requested: Tax Year 1985.

(d) The name and telephone number of a person to contact who is familiar with the information contained in the waiver request.

(e) The type of returns and expected volume of each form.

(f) The reason for the request.

(g) An estimated cost for filing the returns on paper, on magnetic media if *you* prepare the files, and on magnetic media using the services of an agency who will charge you for this service. IF YOU EXPECT TO FILE OVER 500 RETURNS, YOU *MUST* SUBMIT A COPY OF A WRITTEN COST ESTIMATE FOR MAGNETIC MEDIA FILING FROM A SERVICE AGENCY; FOR 500 OR LESS, SUBMIT AN ESTIMATE AS DESCRIBED ABOVE.

.11 If you request a waiver from filing on magnetic media and it *is* approved, *do not send a copy of the ap-*

proved waiver to the service centers. Do *not* staple, paperclip or use rubberbands on any scannable forms. Paper returns are red by an optical scanner (OCR) at the service centers.

.12 Waivers are granted on a case-by-case basis and may be approved at the discretion of the service center or National Computer Center Magnetic Media Coordinators. Refer to Part A, Sec. 13 for addresses. Waiver requests should be filed 90 days before the due date of the return.

.13 If you are required to file on magnetic media but fail to do so, and you do not have an approved waiver on record, you may be subject to a failure to file penalty. Refer to Sec. 6.02 below, except as stated in Sec. 5.08 above.

.14 *An approved waiver from filing information returns on magnetic media does not provide exemption from ALL filing; you MUST submit your information returns on acceptable paper forms.*

.15 A cassette or mini-disk reporting package, which includes all the necessary transmittals, labels, and instructions, will be mailed to all approved filers between October and December of each year.

SEC. 6. FILING OF MAGNETIC MEDIA REPORTS

.01 Section 6011(e) of the Internal Revenue Code, as amended by the Interest and Dividend Tax Compliance Act of 1983, Pub. L. 98-67, 1983-2 C.B. 352, requires that any person, including individuals, estates and trusts, required to file more than 50 information returns in the aggregate for payments of interest (Forms 1099-INT and 1099-OID), dividends (Form 1099-DIV) or patronage dividends (Form 1099-PATR) for any calendar year, must file such returns on magnetic media. For example, if a payer must file 30 Forms 1099-DIV and 25 Forms 1099-INT, filing on magnetic media is required. This requirement shall not apply if you establish that it will cause you undue hardship. Refer to Sec. 5 above.

.02 The penalty for both the failure to timely file certain information returns and failure to file returns as prescribed by IRS is now $50 per payee up to a maximum of $50,000 a year. However, there is no maximum penalty for returns on 1099-INT, 1099-OID, 1099-DIV, 1099-PATR or 5498. If the failure to file is due to intentional disregard of the filing requirements, the penalty may be greater than $50 per payee and there is no maximum penalty.

.03 Generally, payers are now subject to a $50 penalty for *each* failure to include the payee's correct TIN on an information return.

.04 Rev. Proc. 84-24, 1984-1 C.B. 465, gives detailed information on preparing transmittal documents for information returns and is available at your local IRS office. Specific guidelines are given on how to report the payer's name, address and TIN on transmittal documents and information returns. Instructions for multiple transmittals and the submission of transmittals by service bureaus or agents are also covered.

.05 *THE CASSETTE OR MINI-DISK RECORDS ARE TO BE SUBMITTED TO THE NATIONAL COMPUTER CENTER; HOWEVER, PAPER INFORMATION RETURNS ARE TO CONTINUE TO BE FILED WITH THE APPROPRIATE SERVICE CENTERS. See Part A, Sec. 13 for addresses.* Form 4804, Transmittal of Information Returns Reported on Magnetic Media, must accompany cassette or mini-disk submissions. If you file for multiple payers and have the authority to sign the affidavit on Form 4804, you should also submit Form 4802, Multiple Payer Transmittal for Magnetic Media Reporting.

For the IRS to ensure that your actual data records were formatted following THIS revenue procedure, include a hardcopy printout, fast print or cassette or mini-disk dump showing a sample of each type of record (A, B, C, K and F) used on the cassette or mini-disk. This will be reviewed prior to actual processing to ensure that the data is in the proper format. Be sure to include Form 4804, 4802 or computer generated listing *with* your cassette or mini-disk shipment. IRS encourages the use of computer generated Form 4804 which includes *all* necessary information requested on the actual form. *DO NOT MAIL THE CASSTTES OR MINI-DISKS AND THE TRANSMITTAL DOCUMENTS SEPARATELY.*

Paper information returns must be transmitted to the appropriate service center using Form 1096, Annual Summary and Transmittal of U.S. Information Returns. *Do not send information returns filed on paper forms to the National Computer Center.*

.06 The affidavit which appears on Form 1096 and Form 4804 should be signed by the payer; however, the transmitter, service bureau, paying agent, or disbursing agent may sign the affidavit on behalf of the payer if all of the following conditions are met:

(a) It has the authority to sign the affidavit under an agency agreement (either oral, written, or implied) that is valid under the state law.

(b) It has the responsibility (either oral, written, or implied) conferred on it by the payer to request the TINs of borrowers, recipients, or participants reported on magnetic media or paper returns.

(c) It signs the affidavit and adds the caption "For: (name of payer)."

.07 Although a duly authorized agent signs the affidavit, the payer is held responsible for the accuracy of the Form 4804, and the payer will be liable for penalties for failure to comply with filing requirements.

.08 If a portion of the returns are submitted on paper documents with the service center, include a statement on the Form 1096 that the remaining returns are being filed on magnetic media with the National Computer Center. DO NOT REPORT THE SAME INFORMATION ON PAPER FORMS THAT YOU REPORT ON MAGNETIC MEDIA. IF YOU REPORT PART OF YOUR RETURNS ON PAPER AND PART ON MAGNETIC MEDIA, BE SURE THAT DUPLICATE RETURNS, WITH THE SAME INFORMATION, ARE NOT INCLUDED ON BOTH. This does not mean that corrected documents are not to be filed. If a return has been prepared and submitted improperly, you must file a corrected return as soon as

possible. Refer to Part A, Section 10 for requirements and instructions on filing corrected returns.

.09 Reports from different branches for one payer *MUST* be consolidated under one Payer/Transmitter "A" Record for each type of information return. For example, all Forms 1099-INT must be sorted together under one Payer/Transmitter "A" Record followed by the appropriate "B" Records and one "C" Record.

.10 Health care carriers, or their agents, filing Form 1099-MISC per Part A, Sec. 5.07, may submit part of their returns on paper documents and part on magnetic media if the records of some departments are not maintained on computer files. However, an information return is required if the aggregate amount paid to a health care service provider from all departments equals $600 or more. For example, Department A pays $200, Department B pays $300, and Department C pays $100 to the same health care service provider. The aggregate amount paid from all departments equals $600. The health care carrier or agent must submit either one information return for the aggregate amount of $600 or three separate returns from the departments, indicating the amount paid by each department.

.11 Before submitting magnetic media files, include the following:

(a) A signed Form 4804 or computer generated substitute. If you send *two* copies of the Form 4804, one will be used as an acknowledgement.

(b) A Form 4802 (if you transmit for multiple payers).

(c) A hard copy printout or listing of the first five and last two blocks of your file. The listing should show a sample of each type of record (A, B, C, K and F) used on the magnetic media being submitted.

(d) The magnetic media with an external identifying label as described in Part B for Cassette and Part C for Mini-Disk.

(e) On the outside of the shipping container, include a Form 4801 or a substitute for the form which reads "DELIVER UNOPENED TO TAPE LIBRARY—MAGNETIC MEDIA REPORTING—BOX ___ of ___." If there is only one container, mark the outside as Box *1* of 1. For multiple containers, include the sequence (i.e., Box *1* of *33*, *2* of *33*, etc.).

(f) If you were granted an extension and are filing late, include a copy of the approved extension letter with the magnetic media.

.12 IRS will not pay or accept "Collect on Delivery" or "Charged to IRS" shipments of reportable tax information that an individual or organization is legally required to submit. The current policy is to return magnetic materials or requested information at U.S. Government expense.

.13 Files returned to you due to coding or format errors are to be corrected and returned to IRS within 30 days of receipt by the filer.

SEC. 7. FILING DATES

.01 The dates prescribed for filing paper returns with IRS also apply to magnetic media filing. Magnetic media reporting to the IRS for all types of Form 1098, 1099 Series, 5498, and W-2G must be on a calendar year basis.

.02 Information returns filed on magnetic media for Forms 1098, all types of Forms 1099, and W-2G must be submitted to IRS by February 28. The due date for furnishing the required copy or statement to the recipient is January 31.

.03 Information returns filed on magnetic media for Form 5498 must be submitted to IRS by May 31. Copies of this form or statements are due to the participant by May 31 for contributions made to IRAs and SEPs; however, participant copies or statements for DECs are due the time the contribution is made or January 31, whichever is the later. Form 5498 is filed for contributions to be applied to 1985 that are made between January 1, 1985, and April 15, 1986.

SEC. 8. EXTENSIONS OF TIME TO FILE

.01 If a payer or transmitter of returns on magnetic media is unable to submit their magnetic media file by the dates prescribed in Sec. 7.02 and 7.03 above, submit a letter requesting an extension of up to 30 days to file, as soon as you are aware that an extension will be necessary. The request *MUST* be filed *before* the due date of the return. The letter should be sent to the attention of the Magnetic Media Reporting Program at the National Computer Center where the cassette or mini-disk file is to be submitted. See Part A, Sec. 13 for the address. The request should include:

(a) The filer's name and address.

(b) The filer's Taxpayer Identification Number (SSN or EIN).

(c) The tax year for which the extension of time is requested: tax year 1985.

(d) The name and telephone number of a person to contact who is familiar with the request.

(e) The type of returns and expected volume.

(f) The Transmitter Control Code assigned to the organization or individual requesting the extension (if a number has been assigned).

(g) The reason for the delay and date that you *will* be able to file.

.02 If an extension of time to file on magnetic media is granted by the National Computer Center, a *copy* of the letter *granting the extension MUST* be attached to the transmittal Form 4804 or computer generated substitute when the file is submitted.

SEC. 9. PROCESSING OF MAGNETIC MEDIA RETURNS

.01 The National Computer Center will process tax information from magnetic media files. All magnetic media files that are received timely by the National Computer Center will be returned to the filers by August 15 of the year in which submitted.

.02 After January 1, 1986, all magnetic media processing will be centralized at the National Computer Center. Due to the volume of input received and the cost to return special containers, special shipping containers should not be used for transmitting data to the National Computer Center since IRS cannot guarantee return of such containers.

.03 Files will be returned to you for correction if they are unprocessable

due to format or coding errors, or by the request of the filer. Files must be corrected and returned to the National Computer Center within 30 days of receipt by the filer. The corrected files will be returned to the filer by the National Computer Center within 6 months of receipt. PLEASE BE SURE THAT YOUR FORMAT AND CODING COMPLY WITH THIS REVENUE PROCEDURE. *THIS REVENUE PROCEDURE IS TO BE USED FOR THE PREPARATION OF TAX YEAR 1985 INFORMATION RETURNS ONLY.* AS SOME LEGISLATIVE AND FORMS CHANGES AFFECTING INFORMATION RETURNS OCCUR EACH YEAR, THIS PROCEDURE IS UPDATED TO REFLECT NECESSARY CHANGES. PLEASE READ THIS PUBLICATION CAREFULLY.

SEC. 10. HOW TO FILE CORRECTED RETURNS

.01 If a return has been prepared and submitted improperly, you must file a complete corrected return as soon as posssible. *ALL FIELDS OR BOXES MUST BE COMPLETED WITH THE CORRECT INFORMATION, NOT JUST THE DATA FIELDS NEEDING CORRECTION.* If you file corrected returns on paper forms, submit Copy A to the appropriate service center. There are numerous types of errors. It may require more than one transaction to properly correct the initial error. You are strongly encouraged to read this *ENTIRE* section before attempting to make *ANY* correction. If the initial return was filed as an aggregate, you must consider this in filing the corrected returns.

.02 Corrected returns submitted to IRS on magnetic media, using a "G" coded Payee "B" Record, may be submitted on the same cassette or minidisk as those corrections submitted *without* the "G" code; however, they must be submitted using a separate "A" Record. Corrected returns for different tax years may not be submitted on the same file. Corrected returns are to be identified as corrections on the transmittal document and the *EXTERNAL* label of the file.

.03 The instructions that follow will provide information on how to file corrected returns on magnetic media *and* on paper forms. Please refer to the appropriate chart *and* type of error for instructions on how to *properly* file the corrected return(s).

.04 You may file corrected returns on paper forms; however, you are encouraged to file on magnetic media if you file *more* than 50 corrected returns.

.05 If you file your corrected returns on paper forms, do not submit the paper returns to the National Computer Center. *All paper returns, whether original or corrected, must be filed with the appropriate service center. Corrected returns filed on magnetic media must be filed with the National Computer Center.* Refer to Part A, Sec. 13 for address information.

.06 Statements to the recipient or participant should be identified as "CORRECTED" and should be provided to them as soon as possible.

.07 If you file corrected returns on paper forms, use IRS forms or acceptable OCR scannable paper substitutes. Always submit Copy A to the appropriate service center. *NOTE:* Form W-2G is not required to be in OCR scannable format. Publication 1179, "Requirements for Reproducing Paper Substitutes of Forms 1096, 1099 Series, 5498, W-2G and W-3G" provides requirements and instructions. A supplement will be issued to include instructions for paper substitutes of Form 1098, Mortgage Interest Statement.

.08 For further instructions on filing information returns with IRS, refer to the 1985 "Instructions for Form 1099 Series, 1098, 5498 and 1096." If these instructions are not included in your magnetic media reporting packages, request a copy from your local IRS office.

.09 Type or machine print all information on returns filed on paper.

.10 Use the proper form. If you are in doubt, review the instructions noted in .08 above or contact your local IRS office.

.11 Use only the boxes provided on the paper forms. Do not add additional boxes.

.12 Do not change the title of any box on the paper forms.

.13 Use the same name and TIN (SSN or EIN) for the filer on the Form 1096 transmittal form and all related forms that follow.

.14 A separate transmittal Form 1096 is required for each *type* of paper information return filed in the 1098, 5498 and 1099 Series. A transmittal Form W-3G is required to transmit paper Forms 1099-R and W-2G. DO NOT USE THE SAME TRANSMITTAL DOCUMENT TO FILE ORIGINAL AND CORRECTED RETURNS WHETHER ON PAPER FORMS *OR* MAGNETIC MEDIA. A transmittal Form 4804 or computer generated substitute is used to transmit magnetic media. A Form 4802 is a *continuation* form for a Form 4804. Please utilize a Form 4802 if you file on magnetic media for multiple payers and are an authorized agent for the payers.

.15 Do not staple, fold, paperclip or use rubberbands on any paper information returns filed with IRS. This could impair the OCR scanning process.

.16 Use the correct tax year's forms to file information returns with IRS (i.e., do not submit tax year 1985 returns using 1984 forms). The same is true for magnetic media filing. You must submit your returns filed on magnetic media using the revenue procedure for the tax year of the returns. Forms and revenue procedures are normally updated each year to include necessary changes.

.17 Most information returns contain a "VOID" box and a "CORRECTED" box. The "VOID" box is used only if you make an error while typing or printing the paper forms. Mark this box ONLY when you wish the return to be disregarded or passed over. The OCR scanner at the service centers *will not read* a "VOID" return; it will pass over it and go to the next form if the "VOID" box is marked. Do not confuse the "VOID" box and the "CORRECTED" box.

.18 On magnetic media files, the Payee "B" Record provides space to enter a Payer's Account Number for the Payee. This same account number may be provided on paper forms. In order to

properly file corrected returns, this number will help identify the appropriate incorrect return. DO NOT ENTER A TIN (SSN OR EIN). *A PAYER'S ACCOUNT NUMBER FOR THE PAYEE MAY BE A CHECKING ACCOUNT NUMBER, SAVINGS ACCOUNT NUMBER, SERIAL NUMBER OR ANY OTHER NUMBER ASSIGNED TO THE PAYEE BY THE PAYER, WHICH WILL DISTINGUISH THE SPECIFIC ACCOUNT. THIS NUMBER MUST APPEAR ON THE INITIAL RETURN AND ON THE CORRECTED RETURN IN ORDER TO IDENTIFY AND PROCESS THE CORRECTION PROPERLY.*

.19 REVIEW BOTH CHARTS 1 AND 2 THAT FOLLOW. The types of errors made will *normally* fall under one of the four categories listed. Next to each *type* of error made, you will find a list of instructions to tell you how to *properly* file the corrected return for *that* type of error. READ ALL OF THE INSTRUCTIONS LISTED AND FOLLOW THEM FOR THE TYPE OF ERROR MADE ON THE INITIAL RETURN. *IN SOME CASES TWO TRANSACTIONS ARE REQUIRED TO PROPERLY FILE CORRECTIONS. IF THE ORIGINAL RETURN WAS FILED AS AN AGGREGATE, YOU MUST CONSIDER THIS IN FILING THE CORRECTED RETURNS.*

CHART 1. *Guidelines for Filing Corrected Returns on Magnetic Media*

(PLEASE READ SEC. 10.01 THROUGH 10.19 OF THIS PUBLICATION BEFORE MAKING *ANY* CORRECTIONS)

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On Magnetic Media
1. Original return was filed with *NO* Payee TIN (SSN or EIN) *OR* the return was filed with an *INCORRECT* Payee TIN (SSN or EIN). THIS WILL REQUIRE TWO SEPARATE TRANSACTIONS TO MAKE THE CORRECTION PROPERLY. READ AND FOLLOW ALL INSTRUCTIONS FOR BOTH TRANSACTIONS 1 AND 2.	*TRANSACTION 1:* Identifying return submitted with *NO* TIN or an *INCORRECT* TIN A. *Form 4804 and/or 4802 (or computer generated substitute)* 1. Prepare a *new* transmittal Form 4804 (and 4802 if you file for multiple payers), or a computer generated substitute, that includes information related to this new file. (A Form 4802 is a continuation form for multiple payers and may be used if you have the authority to sign the affidavit on the Form 4804.) 2. Write, type or machine print in uppercase letters "MAGNETIC MEDIA CORRECTION" at the top of the transmittal form or computer generated substitute. 3. Provide *ALL* requested information correctly. 4. Include a hardcopy print, listing or cassette or mini-disk dump exhibiting a small sample of each type of *record* (A, B, C and F), which can be reviewed for accuracy and acceptability of record *format*. 5. If you are a Combined Federal/State filer on Mini-Disk, IRS will not transmit corrected returns to the state. This will be the responsibility of the filer. B. *1098, 1099 Series, 5498 and W-2G Returns* 1. Prepare a new file. 2. Use a separate Payer/Transmitter "A" Record for each *type* of return being reported. The information in the "A" Record will be the same as it was in the original submission. 3. The Payee "B" Record must contain exactly the same information as submitted previously *EXCEPT*: insert a "G" code in cassette position 5 or mini-disk position 6 of the "B" Record *AND* for ALL payment amounts used, enter "0" (zero). 4. Corrected returns submitted to IRS using a "G" coded "B" Record may be submitted on the same cassette or mini-disk as those corrections submitted *without* the "G" code; however, a separate "A" Record is required.

Chart 1. (Continued)

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On Magnetic Media
	5. Mark the *EXTERNAL* label of the cassette or mini-disk "MAGNETIC MEDIA CORRECTION." 6. Submit the cassette(s) or mini-disk(s), a cassette or mini-disk dump showing sample records coded for this type of filing, and the transmittal document to the National Computer Center. (Refer to Part A, Sec. 13 for address information.) *TRANSACTION 2:* Reporting the correct information A. *Form 4804 and/or 4802 (or computer generated substitute)* 1. If you submit records with the corrected information on a separate cassette or mini-disk from those that are "G" coded, prepare a *new* transmittal Form 4804 (and 4802 if you file for multiple payers), or a computer generated substitute, that includes information related to this new file. (A Form 4802 is a continuation form for multiple payers and may be used if you have the authority to sign the affidavit on the Form 4804.) 2. Write, type or machine print in uppercase letters "MAGNETIC MEDIA CORRECTION" at the top of the transmittal form or computer generated substitute. 3. Provide *ALL* requested information correctly. 4. Include a hardcopy print, listing or cassette or mini-disk dump exhibiting a small sample of each type of *record* (A, B, C and F), which can be reviewed for accuracy and acceptability of record *format.* 5. If you are a Combined Federal/State filer on Mini-Disk, IRS will not transmit corrected returns to the state. This will be the responsibility of the filer. B. *1098, 1099 Series, 5498 and W-2G Returns* 1. Prepare a *new* file with the correct information in *ALL* records. 2. Use a separate Payer/Transmitter "A" Record for each *type* of return being reported. 3. *Do not code the Payee "B" Record as a corrected return for this type of correction.* (Remove the "G" Code.) 4. Provide all of the correct information supplying the correct TIN (SSN or EIN). 5. Mark the *EXTERNAL* label of the cassette or mini-disk "MAGNETIC MEDIA CORRECTION." 6. Submit the cassette(s) or mini-disk(s), a cassette or mini-disk dump showing sample records coded for this type of filing, and the transmittal document to the National Computer Center. (Refer to Part A, Sec. 13 for address information.)
2. Original return was filed with an incorrect payment amount(s) in the Payee "B" Record, *OR* a money amount was reported using an incorrect Payment Amount Indicator Code in the original Payer/Transmitter "A" Record. Correct *Type Of Return* indicator was used in the "A" Record. THIS WILL REQUIRE ONLY ONE TRANSACTION TO	A. *Form 4804 and/or 4802 (or computer generated substitute)* 1. Prepare a *new* transmittal Form 4804 (and 4802) if you file for multiple payers), or a computer generated substitute, that includes information related to this new file. (A Form 4802 is a continuation form for multiple payers and may be used if you have the authority to sign the affidavit on the Form 4804.)

Chart 1. (Continued

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On Magnetic Media
MAKE THE CORRECTION. (NOTE: If the wrong *Type Of Return* indicator was used, see number 3 of this chart.)	2. Write, type or machine print in uppercase letters "MAGNETIC MEDIA CORRECTION" at the top of the transmittal form or computer generated substitute. 3. Provide *ALL* requested information correctly. 4. Include a hardcopy print, listing or cassette or mini-disk dump exhibiting a small sample of each type of *record* (A, B, C and F), which can be reviewed for accuracy and acceptability of record *format*. 5. If you are a Combined Federal/State filer on Mini-Disk, IRS will not transmit corrected returns to the state. This will be the responsibility of the filer. B. *1098, 1099 Series, 5498 and W-2G Returns* 1. Prepare a *new* file. 2. Use a separate Payer/Transmitter "A" Record for each *type* of return being reported. The information in the "A" Record will be the same as it was in the original submission EXCEPT, the *correct* Amount Indicators will be used. 3. The Payee "B" Record must contain exactly the same information as submitted previously *EXCEPT:* insert a "G" code in cassette position 5 or mini-disk position 6 of the "B" Record *AND* report the correct payment amounts as they should have been reported on the initial return. 4. Corrected returns submitted to IRS using a "G" coded "B" Record may be submitted on the same cassette or mini-disk as those corrections submitted *without* the "G" code; however, a separate "A" Record is required. 5. Mark the *EXTERNAL* label of the cassette or mini-disk "MAGNETIC MEDIA CORRECTION." 6. Submit the cassette(s) or mini-disk(s), a cassette or mini-disk dump showing sample records coded for this type of filing, and the transmittal document to the National Computer Center. (Refer to part A, Sec. 13 for address information.)
3. Original return was filed using the WRONG *Type of Return* indicator in the Payer/Transmitter "A" Record. (For example, a return was coded using the *Type of Return* indicator for 1099-DIV and it should have been coded 1099-INT.) THIS WILL REQUIRE TWO SEPARATE TRANSACTIONS TO MAKE THE CORRECTION PROPERLY. READ AND FOLLOW *ALL* INSTRUCTIONS FOR *BOTH* TRANSACTIONS 1 AND 2.	*TRANSACTION 1:* Identifying return submitted with an incorrect Type Of Return indicator A. *Form 4804 and/or 4802 (or computer generated substitute)* 1. Prepare a *new* transmittal Form 4804 (and 4802 if you file for multiple payers), or a computer generated substitute, that includes information related to this new file. (A Form 4802 is a continuation form for multiple payers and may be used if you have the authority to sign the affidavit on the Form 4804.) 2. Write, type or machine print in uppercase letters "MAGNETIC MEDIA CORRECTION" at the top of the transmittal form or computer generated substitute. 3. Provide *ALL* requested information correctly. 4. Include a hardcopy print, listing or cassette or mini-disk dump exhibiting a small sample of each type of *record* (A, B, C and F), which can be reviewed for accuracy and acceptability of record *format*.

Chart 1. (Continued)

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On Magnetic Media

5. If you are a Combined Federal/State filer on Mini-Disk, IRS will not transmit corrected returns to the state. This will be the responsibility of the filer.

B. *1098, 1099 Series, 5498 and W-2G Returns*

1. Use a separate Payer/Transmitter "A" Record for each *type* of return being reported. The information in the "A" Record will be exactly the same as it was in the original submission using the same incorrect type of return indicator.
2. The corrected Payee "B" Record must contain the same information as submitted previously *EXCEPT:* insert a "G" code in cassette position 5 or mini-disk position 6 of the "B" Record and for *ALL* payment amounts *used,* enter "0" (zero).
3. Corrected returns submitted to IRS using a "G" coded "B" Record may be submitted on the same cassette or mini-disk as those corrections submitted *without* the "G" code; however, a separate "A" Record is required.
4. Mark the *EXTERNAL* label of the cassette or mini-disk "MAGNETIC MEDIA CORRECTION."
5. Submit the cassette(s) or mini-disk(s), a cassette or mini-disk dump showing sample records coded for this type of filing, and the transmittal document to the National Computer Center. (Refer to Part A, Sec. 13 for address information.)

TRANSACTION 2: Reporting the correct information

A. *Form 4804 and/or 4802 (or computer generated substitute)*

1. If you submit records with the corrected information on a separate cassette or mini-disk from those that are "G" coded, prepare a *new* transmittal Form 4804 (and 4802 if you file for multiple payers), or a computer generated substitute, that includes information related to this new file. (A Form 4802 is a continuation form for multiple payers and may be used if you have the authority to sign the affidavit on the Form 4804.)
2. Write, type or machine print in uppercase letters "MAGNETIC MEDIA CORRECTION" at the top of the transmittal form or computer generated substitute.
3. Provide *ALL* requested information correctly.
4. Include a hardcopy print, listing or cassette or mini-disk dump exhibiting a small sample of each type of *record* (A, B, C and F), which can be reviewed for accuracy and acceptability of record *format.*
5. If you are a Combined Federal/State filer, IRS will not transmit corrected returns to the state. This will be the responsibility of the filer.

B. *1098, 1099 Series, 5498 and W-2G Returns*

1. Prepare a *new* file with the correct information in *ALL* records.
2. Use a separate Payer/Transmitter "A" Record for each *type* of return being reported and use the correct Type Of Return indicator.

Chart 1. (Continued)

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On PAPER forms
	3. *Do not code the Payee "B" Record as a corrected return for this type of correction.* (Remove the "G" Code.) 4. Provide all of the correct information. 5. Mark the *EXTERNAL* label of the cassette or mini-disk "MAGNETIC MEDIA CORRECTION." 6. Submit the cassette(s) or mini-disk(s), a cassette or mini-disk dump showing sample records coded for this type of filing, and the transmittal document to the National Computer Center. (Refer to Part A, Sec. 13 for address information.)

CHART 2. *Guidelines for Filing Corrected Returns On Paper Forms*

(PLEASE READ SEC. 10.01 THROUGH 10.19 OF THIS PUBLICATION BEFORE MAKING *ANY* CORRECTIONS)

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On PAPER forms
1. Original return was filed with *NO* Payee TIN (SSN or EIN), *OR* the return was filed with an *INCORRECT* Payee TIN. THIS WILL REQUIRE TWO SEPARATE TRANSACTIONS TO MAKE THE CORRECTION PROPERLY. READ AND FOLLOW *ALL* INSTRUCTIONS FOR BOTH TRANSACTIONS 1 *AND* 2.	*TRANSACTION 1:* Identifying return submitted with *NO* TIN or an *INCORRECT* TIN A. *Form 1096 or W-3G* 1. Prepare a *new* transmittal Form 1096 or W-3G depending on the *type* of return being filed. 2. *Mark over the "X" in the "CORRECTED" box at the top of the form.* 3. Provide *all* requested information correctly. 4. Type or machine print in upper case letters "MAGNETIC MEDIA CORRECTION" in the blank space below the instructions. 5. Do *NOT* staple this transmittal form to the related returns. 6. Use a separate transmittal form for each *type* of return. 7. A transmittal Form 1096 or W-3G *MUST* be present. (Refer to .14 of this section for clarification.) B. *Form 1098, 1099 Series, 5498 or W-2G* 1. Prepare a *new* information return on the proper *type* of form. 2. *Mark over the "X" in the "CORRECTED" box at the top of the form(s).* 3. Enter the Payer, Recipient and Account Number information (if any) *exactly* as it appeared on the original incorrect return filed with *NO* TIN or *INCORRECT* TIN; HOWEVER, enter "0" (zero) for *all* money amounts. 4. File the transmittal document and Copy A of the returns with the appropriate service center. 5. Do *NOT* cut the forms that are three to a page. 6. Do *NOT* staple, paperclip or use rubberbands on the forms. 7. Use a separate transmittal Form 1096 or Form W-3G (depending on the *type* of return) to transmit the "CORRECTED" return(s). 8. *Do NOT include copies of the original return that was filed incorrectly.*

Chart 2. (Continued)

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On PAPER forms
	TRANSACTION 2: Reporting correct information A. *Form 1096 or W-3G:* 1. Prepare a *new* transmittal Form 1096 or W-3G depending on the *type* of return being filed. 2. *Do NOT mark over the "X" in the "CORRECTED" box at the top of the form for THIS type of correction.* 3. Provide *all* requested information correctly. 4. Type or machine print in upper case letters "MAGNETIC MEDIA CORRECTION" in the blank space below the instructions. 5. Do *NOT* staple this transmittal form to the related returns. 6. Use a separate transmittal form for each *type* of return. 7. A transmittal Form 1096 or W-3G *MUST* be present. (Refer to .14 of this section for clarification.) B. *Form 1098, 1099 Series, 5498 or W-2G:* 1. Prepare a *new* information return on the proper *type* of form. 2. *Do NOT mark over the "X" in the "CORRECTED" box at the top of the form(s) for this type of correction.* Submit the *new* returns as though they were originals. 3. Include *all* of the correct information supplying the TIN (SSN or EIN). 4. File the transmittal document and Copy A of the returns with the appropriate service center. 5. Do *NOT* cut the forms that are three to a page. 6. Do *NOT* staple, paperclip or use rubberbands on the forms. 7. Use a separate transmittal Form 1096 or W-3G (depending on the *type* of return) to transmit the corrected returns. *You MUST NOT use the same transmittal used in Transaction 1.* 8. *Do NOT include copies of the original return that was filed incorrectly.*
2. Original return was filed with incorrect payment amount(s) in the Payee "B" Record, OR a money amount was reported using an incorrect payment Amount Indicator Code in the original Payer/Transmitter "A" Record. Correct *Type* of *Return* indicator was used in the "A" Record. THIS WILL REQUIRE ONLY ONE TRANSACTION TO MAKE THE CORRECTION. (If the WRONG *Type* of *Return* indicator was used, see number 3 of this chart.)	A. *Form 1096 or W-3G* 1. Prepare a *new* transmittal Form 1096 or W-3G depending on the *type* of return being filed. 2. *Mark over the "X" in the "CORRECTED" box at the top of the form.* 3. Provide *all* requested information correctly. 4. Type or machine print in upper case letters "MAGNETIC MEDIA CORRECTION" in the blank space below the instructions. 5. Do *NOT* staple this transmittal form to the related returns. 6. Use a separate transmittal form for each *type* of return. 7. A transmittal Form 1096 or W-3G *MUST* be present. (Refer to .14 of this section for clarification.) B. *Form 1098, 1099 Series, 5498 or W-2G* 1. Prepare a *new* information return on the proper *type* of form. 2. *Mark over the "X" in the "CORRECTED" box at the top of the form(s).* 3. Enter the Payer, Recipient and Account Number information *exactly* as it appeared on the original incorrect return; HOWEVER, *enter all correct money amounts in*

Chart 2. (Continued)

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On PAPER forms
	the correct boxes as they should have appeared on the original return. 4. File the transmittal document and Copy A of the returns with the appropriate service center. 5. Do *NOT* cut the forms that are three to a page. 6. Do *NOT* staple, paperclip or use rubberbands on the forms. 7. Use a separate transmittal Form 1096 or W-3G (depending on the *type* of return) to transmit the corrected returns. 8. *Do NOT include copies of the original return that was filed incorrectly.*
3. Original return was filed using the WRONG *Type of Return* indicator in the Payer/Transmitter "A" Record. (For example, a return was coded using the *Type of Return* indicator for 1099-DIV and it should have been coded as 1099-INT.) THIS WILL REQUIRE TWO SEPARATE TRANSACTIONS TO MAKE THE CORRECTION PROPERLY. READ AND FOLLOW *ALL* INSTRUCTIONS FOR BOTH TRANSACTIONS 1 AND 2.	*Transaction 1:* Identifying return submitted with an incorrect Type Of Return indicator A. *Form 1096 or W-3G* 1. Prepare a *new* transmittal Form 1096 or W-3G depending on the *type* of return being filed. 2. *Mark over the "X" in the "CORRECTED" box at the top of the form.* 3. Provide *all* requested information correctly. 4. Type or machine print in upper case letters "MAGNETIC MEDIA CORRECTION" in the blank space below the instructions. 5. Do *NOT* staple this transmittal form to the related returns. 6. Use a separate transmittal form for each *type* of return. 7. A transmittal Form 1096 or W-3G *MUST* be present. (Refer to .14 of this section for clarification.) B. *Form 1098, 1099 Series, 5498 or W-2G* 1. *Prepare a new information return on the same type of form that was used initially.* 2. *Mark over the "X" in the "CORRECTED" box at the top of the form(s).* 3. Enter the Payer, Recipient and Account Number information *exactly* as it appeared on the original incorrect return; HOWEVER, enter "0" (zero) for *all* money amounts. 4. File the transmittal document and Copy A of the returns with the appropriate service center. 5. Do *NOT* cut the forms that are three to a page. 6. Do *NOT* staple, paperclip or use rubberbands on the forms. 7. Use a separate transmittal Form 1096 or W-3G (depending on the *type* of return) to transmit the "CORRECTED" return(s). 8. *DO NOT include copies of the original return that was filed incorrectly.* *TRANSACTION 2:* Reporting correct information on the correct *type* of return A. *Form 1096 or W-3G* 1. Prepare a *new* transmittal Form 1096 or W-3G depending on the *type* of return being filed. 2. *Do NOT mark over the "X" in the "CORRECTED" box at the top of the form for THIS type of correction.* 3. Provide *all* requested information correctly.

Chart 2. (Continued)

Type of Error Made on the Original Return Filed on Magnetic Media	How to File The Corrected Return On PAPER forms
	4. Type or machine print in upper case letters "MAGNETIC MEDIA CORRECTION" in the blank space below the instructions. 5. Do *NOT* staple this transmittal form to the related returns. 6. Use a separate transmittal form for each *type* of return. 7. A transmittal Form 1096 or W-3G *MUST* be present. (Refer to .14 of this section for clarification.) B. *Form 1098, 1099 Series, 5498 or W-2G* 1. Prepare a *new* information return utilizing the proper *type* of form. 2. *Do NOT mark over the "X" in the "CORRECTED" box at the top of the form(s) for this type of correction.* Submit the new return(s) as though they were originals. 3. Include *all* of the correct information. 4. File the transmittal document and Copy A of the returns with the appropriate service center. 5. Do *NOT* cut the forms that are three to a page. 6. Do *NOT* staple, paperclip or use rubberbands on the forms. 7. Use a separate transmittal Form 1096 or W-3G (depending on the *type* of return) to transmit the corrected returns. You *MUST NOT* use the same transmittal used in Transaction 1. 8. *Do NOT include copies of the original return that was filed incorrectly.*

Sec. 11. TAXPAYER IDENTIFICATION NUMBERS

.01 Under section 6109 of the Internal Revenue Code, recipients of all reportable payments on information returns are required to furnish Taxpayer Identification Numbers (TINs) to the payer. The number must be furnished to the payer whether or not the payee is required to file a tax return or is covered by social security. Refer to Sec. 15 for a definition of Taxpayer Identification Number (TIN).

.02 The recipient's TIN is used to associate and verify amounts reported to IRS with corresponding amounts on tax returns. Therefore, it is particularly important that correct social security and employer identification numbers for payees be provided on magnetic media or paper forms submitted to IRS. *DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROES.*

.03 Under section 6676 of the Internal Revenue Code, a $50 penalty applies for each failure to furnish a TIN to another person who is required to file an information return, and for each failure to include a TIN on an information return. The penalty for payments other than interest or dividends applies unless the failures were due to reasonable cause and not willful neglect.

.04 With respect to all payers of interest and dividends, section 6676 of the Internal Revenue Code provides that the payer must self-assess a *$50 penalty* for each failure to include a payee's TIN or each inclusion of an incorrect TIN on an information return, unless the payer can demonstrate that the payer met the due diligence requirements in attempting to acquire correct TINs for payees. Use form 8210, Self-Assessed Penalties Return.

.05 For any reportable payment, if the payee fails to provide a TIN to the payer or if IRS notifies you that the TIN provided is incorrect, then backup withholding must be instituted for that payee. In the case of notice of an incorrect TIN from IRS, the payer must begin withholding on the 31st day after the notice is received. If the payer receives another TIN in the manner required from the payee within 30 days of notice from IRS, no withholding is required.

.06 The TIN to be furnished to IRS depends primarily upon the manner in which the account is maintained or set up on the payer's record. The TIN to be provided must be that of the owner of the account. If the account is recorded in more than one name, furnish the TIN and name of one of the owners of the account. The TIN provided must be associated with the name of the payee provided in the first name line of the Payee "B" Record. For individuals, including sole proprietors, the payee TIN is the payee's social security number. For other entities, the payee TIN is the payee's employer identification number.

.07 Sole proprietors who are payers should show their employer identification number in the Payer/Transmitter "A" Record. However, sole proprietors who are not otherwise required to have an employer identification number should use their social security number.

.08 Sole proprietors' social security

numbers must be used in the Payee "B" Record.

.09 The charts below will help you determine the number to be furnished to IRS for recipients of reportable payments (payees).

CHART 1. Guidelines for Social Security Numbers

For this type of account:	In the Taxpayer Identification Number field of the Payee "B" Record, enter the SSN of—	In the First Payee Name Line of the Payee "B" Record, enter the name of—
1. An individual's account.	The individual.	The individual.
2. A joint account (Two or more individuals, husband and wife).	The actual owner of the account. (If more than one owner, the first individual on the account.)	The individual whose SSN is entered.
3. Account in the name of a guardian or committee for a designated ward, minor, or incompetent person.	The ward, minor, or incompetent person.	The individual whose SSN is entered.
4. Custodian account of a minor (Uniform Gift to Minors Act).	The minor.	The minor.
5. The usual revocable savings trust account (grantor is also trustee).	The grantor-trustee.	The grantor-trustee.
6. A so-called trust account that is not a legal or valid trust under state law.	The actual owner.	The actual owner.
7. A sole proprietorship.	The owner.	The owner.

CHART 2. Guidelines for Employer Identification Numbers

For this account type—	In the Taxpayer Identification Number field of the Payee "B" Record, enter the EIN of—	In the First Payee Name Line of the Payee "B" Record, enter the name of—
1. A valid trust, estate, or pension trust.	Legal entity.[1]	The legal trust, estate, or pension trust.
2. A corporate account.	The corporation.	The corporation.
3. An association, club, religious, charitable, educational or other tax-exempt organization.	The organization.	The organization.
4. A partnership account held in the name of the business.	The partnership.	The partnership.
5. A broker or registered nominee/middleman.	The broker or nominee/middleman.	The broker or nominee/middleman.
6. Account with the Department of Agriculture in the name of a public entity, such as state or local government, school district or prison, that receives agriculture program payments.	The public entity.	The public entity.

[1]Do not furnish the identification number of the personal representative or trustee unless the name of the representative or trustee is used in the account title.

SEC. 12. EFFECT ON PAPER RETURNS

.01 Cassette or mini-disk reporting of the information returns listed in Part A, Sec. 1 applies only to the original (Copy A).

.02 For payments of dividends or interest (reported on Forms 1099-DIV, 1099-PATR, 1099-INT or 1099-OID), the payer is required to furnish an official Form 1099 to a payee either in a separate mailing by First-Class mail or in person. These forms may not be combined or mailed with other information furnished to the recipient except Form W-9 or other Form 1099 statements. The payer may use substitute Forms 1099 if they are substantially similar to the official forms and if the payer complies with all revenue procedures relating to substitute Forms 1099 in effect at the time (see Publication 1179, Requirements for Reproducing Paper Substitutes of Forms 1096, 1099 Series, 5498, W-2G and W-3G). A supplement will be issued to include instructions for substitutes of Form 1098, Mortgage Interest Statement. Copy B (For Recipient) of the substitute forms must contain the statement "This is important tax information and is being furnished to IRS. If you are required to file a return, a negligence penalty will be imposed on you if this income is taxable and IRS determines that it has not been reported."

.03 Statements to recipients for Forms 1098, 1099-A, 1099-B, 1099-G, 1099-MISC (except for substitute payments in lieu of dividends and tax-exempt interest), 1099-R, 5498 or W-2G need not be a copy of the paper form filed with IRS. It is important that income items be properly classified for Federal tax purposes on the statement the payer gives to recipients. The message "This information is being furnished to IRS" must appear on the statements. The payer may combine the statements with other reports or financial or commercial notices, or expand them to include other information of interest to the recipient. Also, be sure that all copies of the forms are legible and provide the recipient with applicable instructions that appear on the back of the recipient's copy of the official IRS form so that the information may properly be used by the recipient in meeting his or her tax obligations.

.04 If a portion of the returns is reported on cassette or mini-disk and the remainder is reported on paper forms, those returns not submitted on cassette or mini-disk must be filed on official forms or on acceptable paper substitutes meeting specifications in Publication 1179, Requirements for Reproducing Paper Substitutes of Forms 1096, 1099 Series, 5498, W-2G and W-3G. A supplement will be issued to include instructions for substitutes of Form 1098, Mortgage Interest Statement.

SEC. 13. MAGNETIC MEDIA COORDINATOR CONTACTS

.01 On January 1, 1985, the National Computer Center assumed responsibility for the *magnetic media* processing previously handled by the Philadelphia, Kansas City, and Austin Service Centers. Beginning January 1, 1986, magnetic media processing for *all* service centers will be centralized at the National Computer Center. *On or after January 1, 1986, please direct all requests for magnetic media related publications, information, undue hardship waivers, or forms to the following address:*

Magnetic Media Reporting
Internal Revenue Service
National Computer Center
Post Office Box 1359
Martinsburg, WV 25401-1359

Hours of operation at this address will be 8:30 AM until 8:00 PM Eastern Time Zone.

Prior to January 1, 1986, requests for *magnetic media* related publications, forms, undue hardship waivers, or information will still be handled by the following service centers only:

(a) Internal Revenue Service
Andover Service Center
Post Office Box 311
Stop 481
Andover, MA 01810

(b) Internal Revenue Service
Brookhaven Service Center
Post Office Box 486
Holtsville, NY 11742

(c) Internal Revenue Service
Atlanta Service Center
Post Office Box 47-421
Doraville, GA 30362

(d) Internal Revenue Service
Memphis Service Center
Post Office Box 1900
Memphis, TN 38101

(e) Internal Revenue Service
Cincinnati Service Center
Post Office Box 267
201 West Second Street
Covington, KY 41019

(f) Internal Revenue Service
Ogden Service Center
Post Office Box 9941
1160 West 12th Street
Ogden, UT 84409

(g) Internal Revenue Service
Fresno Service Center
Post Office Box 12866
Fresno, CA 93779

.02 The National Computer Center will process returns filed on magnetic media only. *All* information returns filed on paper forms should be submitted to the appropriate service center, not the National Computer Center. Organizations who file their information returns on magnetic media but who submit their corrected returns on paper forms with the Philadelphia, Kansas City and Austin Service Centers, please use the following addresses for returns filed on paper:

(a) Internal Revenue Service
Philadelphia Service Center
Post Office Box 245
Bensalem, PA 19020

(b) Internal Revenue Service
Kansas City Serice Center
2306 East Bannister Road
Stop 36
Kansas City, MO 64131

(c) Internal Revenue Service
Austin Service Center
Post Office Box 934
Austin, TX 78767

SEC. 14. COMBINED FEDERAL/STATE FILING

.01 The Combined Federal/State Program was established to simplify information returns filing for the taxpayer. IRS will accept, upon prior approval, mini-disk files containing state reporting information only for those states listed in Table 1 in this section. *FORMS 1098, 1099-A, 1099-B AND W-2G CANNOT BE FILED UNDER THE COMBINED FEDERAL/STATE FILING PROGRAM. DUE TO THE 256 CHARACTER RECORD RESTRICTION FOR CASSETTE FILERS, CASSETTE TAPES ARE NOT ACCEPTABLE ON THIS PROGRAM. EACH RECORD IN THE COMBINED*

FEDERAL/STATE PROGRAM MUST BE 360 CHARACTERS IN LENGTH; THEREFORE ONLY MINI-DISK FILES ARE ACCEPTABLE.

.02 To request approval to participate in the Combined Federal/State Program, a "test" file, *coded for this program*, must be submitted between September and December using the revenue procedure that will be used for the actual data files. Refer to Part A, Sec. 13 for address information. See Part A, Sec. 5.04 for general guidelines on submission of "test" files. Each record, both in the "test" file and actual data file, must be 360 positions in length, and the file must conform *exactly* to the revenue procedure for the tax year of the *actual* data. Combined Federal/State records must be coded using each state's dollar criteria from Table 2 of this Section for each *type* of return. If the "test" mini-disk is determined to be acceptable, IRS will return it to the filer with a letter of approval to participate in the Combined Federal/State Program. Form 6847, Consent For Internal Revenue Service to Release Tax Information, will be included with the letter of approval. You *must* complete Form 6847, include your 5 character Transmitter Control Code on the form, and return it to IRS before IRS will release tax information to any of the participating states. Do not submit *actual* data records coded for the Combined Federal/State Program without prior approval from IRS. The first time you submit actual data files coded for this program, include the signed Form 6847.

.03 States that participate in this program and the valid state code assigned to each are listed in Table 1 of this Section. If the state that you wish information released to does *not* participate in the program, do *not* code your records for that state. If the state participates, if you have received prior approval, and if all other conditions are met, IRS will forward the tax information to the participating state at no charge to the filer.

.04 *IF CORRECTIONS MUST BE MADE, IRS WILL NOT TRANSMIT CORRECTED RETURNS TO THE STATES. THIS WILL BE THE RESPONSIBILITY OF THE FILER.*

.05 IRS will make no attempt to process files with any deviations. Approval to participate in the Combined Federal/State Program will be revoked if any files are submitted that do not *totally* conform.

.06 IRS is acting as a forwarding agent *ONLY*. Some participating states require separate notification that you are filing in this manner. It is your responsibility to contact the appropriate states for further information.

.07 The appropriate state code should be entered for those documents which meet that state's filing requirements. *It is the filer's responsibility* to determine the state code to be used and to obtain the filing requirements from the appropriate state(s).

.08 If you meet all of the requirements for this program, you *must* provide the state totals from the "K" record on a separate Form 4804, Transmittal of Information Returns on Magnetic Media (or Form 4802, Multiple Payer Transmittal For Magnetic Media Reporting) or computer generated substitute for each state, *or* you must include a listing which identifies each state and the "K" record totals for each.

.09 If you have met *ALL* of the above conditions:

(a) You must submit all records using two 180 position sectors which indicate the appropriate coding related to this program.

(b) The "C" record *must* be followed by a "K" Record for each state. The "K" record indicates the number of payees (different TINs) being reported to each particular state.

(c) Payment amount totals and the valid participating state code must be included in the state totals "K" Record. Refer to Part B, Sec. 16, for a description of the "K" Record.

(d) The "K" record is followed by an end of transmission "F" Record (if this is the last record of the entire file).

.10 Only those states listed in Table 1 below will receive information from IRS. *It is the filer's responsibility to file information returns with states that do not participate in this program.*

TABLE 1. PARTICIPATING STATES AND THEIR CODES

State	*Code*	*State*	*Code*	*State*	*Code*
Alabama	01	Iowa	19	New York	36
Arizona	04	Kansas	20	North Carolina	37
Arkansas	05	Maine	23	North Dakota	38
California	06	Massachusetts	25	Oregon	41
Delaware	10	Minnesota	27	South Carolina	45
District of Columbia	11	Mississippi	28	Tennessee	47
Georgia	13	Missouri	29	Wisconsin	55
Hawaii	15	Montana	30		
Idaho	16	New Jersey	34		
Indiana	18	New Mexico	35		

.11 To simplify filing, several of the participating states have provided lists of their information return reporting requirements (see Table 2). This cumulative list is for information purposes only and represents dollar criteria. For complete information on state filing requirements, contact the appropriate state tax agencies.

TABLE 2. DOLLAR CRITERIA

STATE	1099-R	1099-DIV	1099-INT	1099-MISC	1099 PATR	1099-G	1099-OID	5498
Alabama	1500	1500	1500	1500	1500	NR	1500	NR
Arizona[a]	300	300	300	300	300	300	300	NR
Arkansas	2500	100	100	2500	2500	2500	2500	[i]
District of Columbia[b]	600	600	600	600	600	600	600	NR
Hawaii	600	10	10[c]	600	10	all	10	[i]
Idaho	600	10	10	600	10	10	10	[i]
Iowa	1000	100	1000	1000	1000	1000	1000	NR
Minnesota	600	10	10[d]	600[e]	10	10	10	NR
Missouri	NR	NR	NR	1200[f]	NR	NR	NR	NR
Montana	600	10	10	600	10	10	10	[i]
New Jersey	1000	1000	1000	1000	1000	1000	1000	NR
New York	600	NR	600	600[g]	NR	600	NR	NR
North Carolina	100	100	100	600	100	100	100	[i]
Oregon	600[h]	10	10	600	10	10	10	NR
Tennessee	NR	25	25	NR	NR	NR	NR	NR
Wisconsin	500	100	100	100	100	NR	NR	NR

NR—No filing requirement.

Footnotes:

[a] These requirements apply to individuals and business entities.

[b] Amounts are for aggregates of several types of income from the same payroll.

[c] State regulation changing filing requirement from $600 to $10 is pending.

[d] $10.01 for Savings and Loan Associations and Credit Unions.

[e] $600.01 for Rents and Royalties.

[f] Aggregate both types of returns. The state would prefer those returns filed with respect to non-Missouri residents to be sent directly to the state agency.

[g] Aggregate of several types of income.

[h] Return required for state of Oregon residents only.

[i] Same as federal requirement for this type of return.

*NOTE: Filing requirements for any state not shown on the above chart are the same as the Federal requirement.

SEC. 15. DEFINITIONS OF TERMS

Element	Description
b	Denotes a blank position. Enter blank(s) when this symbol is used (do *not* enter the letter "b"). This appears in numerous areas throughout the record descriptions.
Coding Range	Indicates the allowable codes for a particular type of statement.
EIN	Employer Identification Number that has been assigned by IRS to the reporting entity.
Excess Golden Parachute Payment	Parachute payments (also called "golden parachutes") are certain payments in the nature of compensation which corporations make to key individuals, often in excess of their usual compensation, in the event that ownership or control of the corporation changes.
File	For purposes of this procedure, a file consists of all cassette or mini-disk records submitted by a Payer or Transmitter.
Payee	Person(s) or organization(s) receiving payments from the Payer, or for whom an information return must be filed.
Payer	Person or organization, including paying agent, making payments or the person liable for filing an information return. The Payer will be held responsible for the completeness, accuracy and timely submission of cassette or mini-disk files.

Element	Description
Special Character	Any character that is not a numeral, a letter or a blank
SSA	Social Security Administration.
SSN	Social Security Number.
Taxpayer Identification Number (TIN)	May be either an EIN or SSN.
Transfer Agent (Paying Agent)	The transfer agent or paying agent is the entity who has been contracted or authorized by the payer to perform the services of paying and reporting backup withholding (Form 941). The payer must submit to IRS a Form 2678, Employer Appointment of Agent under Section 3504, which notifies IRS of the transfer agent relationship.
Transmitter	Person or organization preparing cassette or mini-disk file(s). May be Payer or agent of payer.
Transmitter Control Code	A *five* character number assigned by IRS to the transmitter prior to actual filing on magnetic media. This number is inserted in the "A" Record of your files and *must* be present before the file can be processed. An application Form 4419 must be filed with IRS to receive this number. See Part A, Sec. 5. (Abbreviation for this term is TCC.)

SEC. 16. U.S. POSTAL SERVICE STATE ABBREVIATIONS

You *MUST* use the following U.S. Postal Service State abbreviations when developing the state code portion of Name Line fields. (This table provides state abbreviations only and does not represent those states participating in the Combined Federal/State Program. For a list of states that participate in the Combined Federal/State Program, refer to Sec. 14.10.)

State	*Code*	*State*	*Code*	*State*	*Code*
Alabama	AL	Kentucky	KY	North Dakota	ND
Alaska	AK	Louisiana	LA	Ohio	OH
Arizona	AZ	Maine	ME	Oklahoma	OK
Arkansas	AR	Maryland	MD	Oregon	OR
California	CA	Massachusetts	MA	Pennsylvania	PA
Colorado	CO	Michigan	MI	Rhode Island	RI
Connecticut	CT	Minnesota	MN	South Carolina	SC
Delaware	DE	Mississippi	MS	South Dakota	SD
District of Columbia	DC	Missouri	MO	Tennessee	TN
Florida	FL	Montana	MT	Texas	TX
Georgia	GA	Nebraska	NE	Utah	UT
Hawaii	HI	Nevada	NV	Vermont	VT
Idaho	ID	New Hampshire	NH	Virginia	VA
Illinois	IL	New Jersey	NJ	Washington	WA
Indiana	IN	New Mexico	NM	West Virginia	WV
Iowa	IA	New York	NY	Wisconsin	WI
Kansas	KS	North Carolina	NC	Wyoming	WY

PART B. CASSETTE SPECIFICATIONS

SECTION 1. GENERAL

.01 The specifications contained in this part of the revenue procedure prescribe the required format and contents of the records to be included in the cassette file. These specifications must be adhered to unless deviations have been specifically granted by IRS in writing.

.02 In most instances, IRS will be able to process any compatible cassette file. IRS has a Burrough's B-94 model mini-computer with free standing NRZ and PE cassette devices, style B 9497-11 and B 9497-15 respectively. We understand that most Burroughs B-90 series mini-computers will produce compatible cassettes. However, until this is absolutely determined, we request filers to provide test cassettes so that we may ascertain which models are compatible.

.03 A cassette contains a minimum of 282 feet (86m) of 2 track recording tape and a minimum of 6 inches (15.25 cm) of clear leader at both ends of the tape.

.04 The recording technique is either non-return to zero (NRZ) or Phase Encoded (PE).

05 Date is recorded on the cassette at a maximum density of 800 bits per inch (BPI) for NRZ cassettes and 1600 BPI for PE cassettes.

.06 When the NRZ technique is used, both tracks of the cassette are recorded simultaneously; data is recorded on one track and a synchronizing clock impulse is recorded on the other.

.07 When the PE technique is used, there is no requirement for a separate clock pulse track; one track is recorded when the cassette is driven in one direction, and the other track is recorded when the tape drive is driven in the other direction. Therefore two PE data tracks can be recorded over the full length of the tape.

.08 The data is recorded in blocks of characters, separated by interblock gaps (IBGs). Records may not span blocks.

.09. The recording mode is 9 channel ASCII (American Standard Code Information Exchange) or EPCDIC (Extended Binary Coded Decimal Interchange Code.

.10 The industry standard for cassettes is odd parity.

.11 The maximum block size is 256 characters; the minimum block size is 1 character for NRZ cassettes and 8 characters for PE cassettes.

.12 Each block of characters is followed by two 8-bit Cyclic Redundancy CHeck (CRC) characters which serve as a parity check on the data block during reading operations.

.13 The data characters plus the CRC characters are preceeded and followed by a Preamble character and a Postamble character which serve to delimit the data block.

.14 Tape marks which consist of a fixed number of null characters (all zero bits) are used to delimit logical portions of the cassette and also to mark the end of the file of data.

.15 Cassettes may be either labeled or unlabeled.

.16 Each block of data, including tape marks, are separated from the next block by the interblock gap (IBGs). The IBG is 1.4 inches (3.5 cm) in length. A tape mark length is approximately 6 inches (15 cm) in length.

.17 The beginning of the tape is marked by a BOT mark. This is a hole in the tape used to define the start of the recording tape. It is recommended that a tape mark, preamble character, null character (one character in which all bits are zero), a postamble character and ending label is placed on the cassette immediately after EOT is reached.

.18 An external label must appear on each cassette submitted for processing. The following information is needed:

(a) The transmitter's name.

(b) The five character Transmitter Control Code.

(c) The type of computer equipment that the data was prepared on.

(d) The type of drive utilized (e.g., PE or NRZ).

(e) Recording code (e.g., EBCDIC or ASCII).

(f) The tax year of the data (e.g., 1985).

(g) Document types (e.g., 1099 INT).

(h) The total number of payers (from the "F" record).

(i) The total number of payees (from the "C" record).

(j) The total number of cassettes in the file.

(k) A cassette number assigned by the transmitter.

(l) The sequence of each cassette (e.g., 001 of 008).

This information will assist IRS in processing the file or in locating a file, should the transmitter request that it be returned due to errors. IRS advises that special shipping containers not be used for transmitting data since it cannot be guaranteed that they will be returned.

SEC. 2. RECORD LENGTH

.01 The cassette records defined in this revenue procedure may be blocked or unblocked, subject to the following:

(a) The block must not exceed 256 cassette positions.

(b) A record must be a minimum of 200 positions and a maximum of 256 positions. Due to this restriction, cassette filers may not participate in the Combined Federal/State Program; cassette filers may only report a maximum of six payment amounts for any single record; also, Forms 1099-A, 1099-B and W-2G cannot be filed on cassette.

(c) If the use of blocked records would result in a short block, all remaining positions of the block must be filled with 9-s. DO NOT PAD A BLOCK WITH BLANKS.

(d) All records except the Header and Trailer Labels, may be blocked.

(e) Records may not span blocks.

SEC. 3. PAYER/TRANSMITTER "A" RECORD

.01 Identifies the payer and transmitter of the cassette file and provides parameters for the succeeding Payee "B" Records. IRS computer programs rely on the absolute relationship between the parameters and data fields in the "A" Record and the data fields in the "B" Records to which they apply.

.02 The number of "A" Records appearing on a cassette will depend on the number of payers and the different types of returns being reported. After the header label on the cassette, the first record appearing in the file must be an "A" Record. For cassette filing, the *actual* record lengths for the "A" and "B" Records must agree with whatever is entered in cassette positions 28-30 and 31-33 of the "A" Record. A transmitter may include Payee "B" records for more than one payer on a cassette; however, each GROUP of Payee "B" Records must be preceded by an "A" Record. A single cassette may also contain different types of returns, but the types of returns *must* not be intermingled. A separate "A" Record is required for each type of return being reported. An "A" Record may be blocked with "B" records; however, the initial record on a *file* must be an "A" Record. The IRS will accept an "A" Record after a "C" Record. For cassette files, do not begin any record at the end of a block and continue the same record into the next block.

RECORD NAME: PAYER/TRANSMITTER "A" RECORD

Cassette Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "A".
2	Payment Year	1	REQUIRED. Must be the right most digit of the year for which information is being reported. (e.g., if payments were made in 1985, enter "5"). Must be incremented each year.
3-5	Cassette Sequence Number	3	REQUIRED. Sequence numbers of the cassette in the file starting with 001.
6-14	Payer's Federal EIN	9	REQUIRED. Must be the *valid* 9-digit number assigned to the payer by IRS. DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROES.
15-16	Blank	2	REQUIRED. Enter blanks.
17	Type of Return	1	REQUIRED. Enter appropriate code from table below: *Type of Return* — *Code* 1098 — 3 1099-DIV — 1 1099-G — F 1099-INT — 6 1099-MISC — A 1099-OID — D 1099-PATR — 7 1099-R — 9 5498 — L NOTE: Forms 1099-A, 1099-B and W-2G cannot be filed on cassette due to the 256 character record restriction.
18-23	Amount Indicators	6	REQUIRED. In most cases, the boxes or Amount Indicators on paper information returns correspond with the Amount Codes used to file on magnetic media; however, should you notice discrepancies, please disregard them and program according to this revenue procedure for your returns filed on magnetic media. The amount indicators entered for a given type of return indicate type(s) of payment(s) which were made. Example: If position 17 of the Payer/Transmitter "A" Record is "6" (for 1099-INT) and positions 18-23 are "123bbbbbb," this indicates that 3 payment amount fields are present in all of the following Payee "B" Records. The first payment amount field in the Payee "B" Record will represent Earnings from savings and loan associations, credit unions, bank deposits, bearer certificates of deposit, etc., the second will represent Amount of forfeiture, and the third will represent Federal income tax withheld. Enter the Amount Indicators in ASCENDING SEQUENCE, left justify, filling unused positions with blanks. For any further clarification of the Amount Indicator codes, you may contact the service center or National Computer Center Magnetic Media Coordinators listed in Part A, Sec. 13.

Cassette Position	Field Title	Length	Description and Remarks
	Amount Indicators Form 1098—Mortgage Interest Statement (New Form)		For Reporting Mortgage Interest Received from Payer(s) on Form 1098: Amount Code — Amount Type 1 — Mortgage interest received from payer(s) 2 — Optional field for items such as real estate taxes or insurance paid from escrow
	Amount Indicators Form 1099-DIV—Dividends and Distributions		For Reporting a maximum of six Payments on Form 1099-DIV: Amount Code — Amount Type 1 — Gross dividends and other distributions on stock 2 — Dividends qualifying for exclusion 3 — Dividends not qualifying for exclusion 4 — Federal income tax withheld 5 — Capital gain distributions 6 — Nontaxable distributions (if determinable) 7 — Foreign tax paid 8 — Cash liquidation distributions 9 — Noncash liquidation distributions (Show fair market value)
	Amount Indicators Form 1099-G—Certain Government Payments		For Reporting Payments on Form 1099-G: Amount Code — Amount Type 1 — Unemployment compensation 2 — State or local income tax refunds 4 — Federal income tax withheld 5 — Discharge of indebtedness 6 — Taxable grants 7 — Agriculture payments
	Amount Indicators Form 1099-INT—Interest Income		For Reporting Payments on Form 1099-INT: Amount Code — Amount Type 1 — Earnings from savings and loan associations, credit unions, bank deposits, bearer certificates of deposit, etc. 2 — Amount of forfeiture 3 — Federal income tax withheld 4 — Foreign tax paid (if eligible for foreign tax credit) 5 — U.S. Savings Bonds, etc.
	Amount Indicators Form 1099-MISC—Miscellaneous Income (See Notes 1, 2 and 3)		For Reporting Payments on Form 1099-MISC: Amount Code — Amount Type 1 — Rents 2 — Royalties 3 — Prizes and awards 4 — Federal income tax withheld

Cassette Position	Field Title	Length	Description and Remarks
			5 Fishing boat proceeds 6 Medical and health care payments 7 Nonemployee compensation 8 Direct sales *"indicator"* (see NOTE 1) 9 Substitute payments in lieu of dividends or interest (see NOTE 2)

NOTE 1: Use Amount Code "8" to report *direct sales* of $5000 or more of consumer products on a buy-sell, deposit-commission, or other basis *for resale*. If *not* for resale, enter a "0" (zero) in tape position 4 of the Payee "B" Record. Please refer to the "B" Record Document Specific Code for clarification. The use of Amount Code "8" actually reflects an *indicator* of *direct sales* and not an actual payment amount or amount code. The corresponding payment amount field in the Payee "B" record MUST be reflected as 0000000100. This does not mean that a payment of $1.00 was made or is being reported. The use of Amount Code "8" relates directly to cassette position 4, Document Specific Code and Note 2 of the Payment Amount Field in the Payee "B" Record.

NOTE 2: Brokers are subject to a new reporting requirement for payments received after 1984. Brokers who transfer securities of a customer for use in a short sale must use Amount Code 9 of Form 1099-MISC to report the aggregate payments received in lieu of dividends or tax-exempt interest on behalf of a customer while the short sale was open. Generally, for substitute payments in lieu of dividends, a broker is required to file a Form 1099-MISC for each affected customer who is *not* an individual. Refer to the 1985 "Instructions for Form 1099 Series, 1098, 5498, and 1096" for detailed information. (The instructions are available from local IRS offices.)

NOTE 3: If you are reporting Excess Golden Parachute Payments, use paper forms 1099-MISC. Do not report Excess golden parachute Payments on magnetic media for tax year 1985. See Part A, Sec. 15 for a definition of an Excess Golden Parachute Payment.

Amount Indicators Form 1099-OID—Original Issue Discount

For Reporting Payments on Form 1099-OID:

Amount Code	Amount Type
1	Total original issue document (ratable) for the tax year covered by the return
2	Stated interest (the regular interest paid on this obligation without regard to any original issue discount)
3	Amount of forfeiture
4	Federal income tax withheld

Amount Indicators Form 1099-PATR—Taxable Distributions Received From Cooperatives

For Reporting a maximum of six Payments on Form 1099-PATR:

Amount Code	Amount Type
1	Patronage dividends
2	Nonpatronage distributions
3	Per-unit retain allocations
4	Federal income tax withheld
5	Redemption of nonqualified notices and retain allocations
6	Investment credit (See NOTE)
7	Energy investment credit (see NOTE)
8	Jobs credit (See NOTE)

NOTE: The amounts shown for Amount Indicators "6", "7" and "8" must be reported to the payee; however, since these amounts are not taxable, they need not be reported to IRS.

Cassette Position	Field Title	Length	Description and Remarks
	Amount Indicators Form 1099-R—Total Distributions from Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, Etc. (See NOTE)		For Reporting a maximum of six Payments on Form 1099-R: Amount Code — Amount Type 1 — Amount includable as income (add amounts in codes 2 and 3) 2 — Capital gain (for lump-sum distributions only) 3 — Ordinary income 4 — Federal income tax withheld 5 — Employee contributions to profit-sharing or retirement plans 6 — IRA, SEP or DEC distributions 8 — Net unrealized appreciation in employer's securities 9 — Other NOTE: For tax year 1985 reporting, coding is not provided to report to IRS, on magnetic media, any state income tax withheld.
	Amount Indicators Form 5498—Individual Retirement Arrangement Information		For Reporting Payments on Form 5498: Amount Code — Amount Type 1 — Regular IRA, SEP or DEC contributions made in calendar year 1985 for tax year 1984 reporting 2 — Rollover IRA, SEP or DEC contributions 3 — Regular IRA, SEP or DEC contributions made in calendar year 1985 and 1986 for tax year 1985 reporting 4 — Allocable life insurance cost included in code 3 for endowment contracts only
24-27	Blank	4	REQUIRED. Enter blanks.
28-30	"A" Record Length	3	REQUIRED. . Enter the number of positions used or that you have allowed for the "A" Record. For cassette filing, the actual record length *must* agree with whatever you enter in this field. The record must not exceed 256 characters.
31-33	"B" Record Length	3	REQUIRED. Enter the number of positions used or that you have allowed for the "B" Record. For cassette filing, the actual record length *must* agree with whatever you enter in this field. The record must not exceed 256 characters.
34	Blank	1	REQUIRED. Enter blank.
35-39	Transmitter Control Code (TCC)	5	REQUIRED. Enter the 5 character Transmitter Control Code assigned by IRS. See Part A, Sec. 15 for a definition of Transmitter Control Code (TCC). You must have a TCC to file *actual* data on this program.

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Cassette Position	Field Title	Length	Description and Remarks
40	Blank	1	REQUIRED. Enter blank.
41-80	First Payer Name	40	REQUIRED. Enter the name of the payer in the manner in which it is used in normal business. Any extraneous information must be deleted from the name line. Left justify and fill with blanks.
81-119	Second Payer Name	39	REQUIRED. The contents of this field are dependent upon the TRANSFER AGENT INDICATOR in position 120 of this record. If the Transfer Agent Indicator contains a "1", this Field will contain the name of the Transfer Agent. If the Transfer Agent Indicator contains a "0" (zero), this field will contain either a continuation of the First Payer Name field or blanks. Left justify and fill unused positions with blanks. IF NO ENTRIES ARE PRESENT FOR THIS FIELD FILL WITH BLANKS. (See Part A, Sec. 15 for a definition of Transfer Agent.)
120	Transfer Agent Indicator	1	REQUIRED. Identifies the entity in the Second Payer Name Field. (See Part A, Sec. 15 for a definition of Transfer Agent.) *Code* — *Meaning* 1 — The entity in the Second Payer Name field is the Transfer Agent. 0 (zero) — The entity shown is *not* the Transfer Agent (i.e. the Second Payer Name field contains either a continuation of the First Payer Name field or blanks).
121-160	Payer Shipping Address	40	REQUIRED. If the TRANSFER AGENT INDICATOR in position 120 is a "1" enter the shipping address of the Transfer Agent. Otherwise, enter the shipping address of the payer. Left justify and fill with blanks.
161-200	Payer City, State and Zip Code	40	REQUIRED. If the TRANSFER AGENT INDICATOR in position 120 is a "1" enter the city, state and ZIP Code of the Transfer Agent. Otherwise, enter the city, state and zip code of the payer. Left justify and fill with blanks.
201-256	Blank	56	REQUIRED. Enter Blanks.

SEC. 4. PAYEE "B" RECORD—GENERAL FIELD DESCRIPTIONS

.01 The Payee "B" record contains the payment information from the individual statements. When filing information documents on cassette(s), the format for the Payee "B" Records will vary in relation to the number of payment amount fields being reported. The number of payment amount fields will depend upon the number of Payment Amount Indicator Codes used in positions 18-23 of the Payer/Transmitter "A" Record. For example, if you are reporting 1099-INT, position 17 of the Payer/Transmitter "A" Record will be coded with a "6." If the Amount Indicators used to report this interest are Amount Codes "1," "2," and "3," then cassette positions 18-23 of the "A" record will be coded "123bbb" (b represents a *blank* position). To correspond with Amount Indicators "1," "2," and "3" of the "A" Record, the "B" Record will contain three payment amount fields. Cassette positions 31-40 of the "B" Record will contain the payment

amount to be reported for Amount Code "1" (earnings from savings and loan associations, credit unions, bank deposits, bearer certificates of deposits, etc.); cassette positions 41-50 of the "B" Record would contain the payment amount to be reported for Amount Code "3" (Federal income tax withheld). The First Payee Name Line *must* begin immediately after the last payment amount *that is used*. In this example, the First Payee Name Line would begin in cassette position 61.

.02 All records must be a fixed length. Records may not span blocks. A block may not exceed 256 positions. DO NOT PAD A BLOCK WITH BLANKS. If the use of blocked records would result in a short block, all remaining positions of the block must be filled with 9s.

.03 All payee records *must contain correct payee name and address information* entered in the fields described in this section. Any records containing an invalid TIN (SSN or EIN) and having no address data present will be returned for correction.

.04 IRS must be able to identify the surname associated with the TIN (SSN or EIN) furnished on a statement. The specifications below include a field in the payee records called "Name Control" in which the first four alphabetic characters of the payees' surname or last name are to be entered by the payers. The surname or last name should appear first in the First Payee Name Line of all Payee "B" Records; however, if your records have been developed using the first name first, IRS programs will accept this but, a blank must appear between the first and last name.

.05 If payers are unable to provide the first four characters of the surname, the Name Control Field may be left blank; however, compliance with the following will facilitate IRS computer programs in generating the Name Control.

(a) The surname of the payee whose TIN (SSN or EIN) is shown in the Payee "B" Record should always appear first. If however, you enter the first name first, you must leave a blank space between the first and last name.

(b) In the case of multiple payees, only the surname of the payee whose TIN (SSN or EIN) is shown in the Payee "B" Record, must be present in the First Payee Name Line. Surnames of any other payees in the record must be entered in the Second Payee Name Line.

RECORD NAME: PAYEE "B" RECORD

Cassette Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "B".
2-3	Payment Year	2	REQUIRED. Must be the last two digits of the year for which payments are being reported (e.g., if payments were made in 1985 enter "85"). Must be incremented each year.
4	Document Specific Code	1	REQUIRED for Forms 1099-R, 1099-MISC, and 1099-G. For *Form 1099-R*, enter the appropriate value for the Category of total IRA Distribution. For *Form 1099-MISC*, enter the appropriate value for Direct Sales. For *Form 1099-G*, enter the year of income tax refund. FOR ALL OTHER FORMS, ENTER BLANK.
	Category of Total Distribution (Form 1099-R only)		Use only for reporting on *Form 1099-R* to identify the category of Total Distribution. Enter the applicable code from the table below. Code 7 below is *not required* for Amount Indicators 1, 2 and 3. A "0" (zero) is not a valid code for Form 1099-R.
			Category — *Code* Premature distribution (other than codes 2, 3, 4, or 5) — 1 Rollover — 2 Disability — 3 Death — 4 Prohibited transaction — 5 Other — 6 Normal IRA, SEP or DEC distributions — 7 Excess contributions refunded plus earnings on such excess contributions — 8
	Direct Sales (Form 1099-MISC only)		Use only for direct sales reporting on *Form 1099-MISC*. If sales to the recipient of consumer products on a buy-sell, deposit-commission, or any other basis for resale, have amounted to $5,000 or more, ENTER "1". If not for resale, enter "0" (zero). If you are filing 1099-MISC, with an Amount Indicator of "8" in

Cassette Position	Field Title	Length	Description and Remarks
			the "A" Record, you must enter a code "1" or "0" in this field. In Part B, Sec. 4, information concerning the direct sales indicator can be found under Amount Indicators, Form 1099-MISC, NOTE 1.
	Refund is for Tax Year (Form 1099-G only)		Use only for reporting the tax year for which the refund was issued. If the payment amount field associated with Amount Indicator 2, Income Tax Refunds, contains a refund, credit or offset that is attributable to an income tax which applies exclusively to income from a trade or business and is not of general application, then enter the ALPHA equivalent of the year of refund from the table below. Otherwise, enter the NUMERIC Year for which the Refund was issued.

Year for which Refund was Issued	Alpha Equivalent
1	A
2	B
3	C
4	D
5	E
6	F
7	G
8	H
9	I
0	J

5-6	Blank	2	REQUIRED. Enter blanks. (Reserved for IRS use). Cassette position 5 is used to indicate a corrected return. Refer to Part A, Sec. 10 for specific instructions on how to file corrected returns using either magnetic media or paper forms.
7-10	Name Control	4	REQUIRED. Enter the first 4 letters of the surname of the payee. Surnames of less than four (4) letters should be left justified, filling the unused positions with blanks. Special characters and imbedded blanks should be removed. IF THE NAME CONTROL IS NOT DETERMINABLE BY THE PAYER, LEAVE THIS FIELD BLANK. A dash (–) or ampersand (&) are the only acceptable special characters.
11	Type of TIN	1	REQUIRED. This field is used to identify the Taxpayer Identification Number (TIN) in positions 12-20 as either an Employer Identification Number, a Social Security Number, or the reason no number is shown. Enter the appropriate code from the table below:

Type of TIN	*TIN*	*Type of Account*
1	EIN	A business or an organization
2	SSN	An individual
9	SSN	The payee is a foreign individual and not a U.S. resident
blank	N/A	A Taxpayer Identification Number is required but unobtainable due to legitimate cause; e.g. number applied for but not received.

RECORD NAME: PAYEE "B" RECORD—Continued

Cassette Position	Field Title	Length	Description and Remarks
12-20	Taxpayer Identification Number	9	REQUIRED. Enter the valid 9-digit Taxpayer Identification Number of the payee (SSN or EIN, as appropriate). Where an identification number has been applied for but not received or where there is any other legitimate cause for not having an identification number, *enter blanks*. *DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROS*. Any record containing an invalid identification number in this field will be returned for correction.
21-30	Payer's Account Number for Payee	10	REQUIRED. Payer may use this field to enter the payee's account number. The use of this item will facilitate easy reference to specific records in the payer's file should any questions arise. DO NOT ENTER A TAXPAYER IDENTIFICATION NUMBER IN THIS FIELD. An account number can be any account number assigned by the payer to the payee (i.e., checking account, savings account, etc.). THIS NUMBER WILL HELP TO DISTINGUISH THE INDIVIDUAL PAYEE'S ACCOUNT WITH YOU AND THE SPECIFIC TRANSACTION MADE WITH THE ORGANIZATION, SHOULD MULTIPLE RETURNS BE FILED. This information will be particularly necessary if you need to file a corrected return. You are strongly encouraged to use this field. You may use any number that will help identify the particular transaction that you are reporting.
	Payment Amount Fields		The number of payment amounts is dependent upon and must agree with the number of Amount Indicators present in positions 18-23 of the "A" Record. For cassette filers, a maximum of six payment amounts may be present. *THE FIRST PAYEE NAME LINE MUST APPEAR IMMEDIATELY AFTER THE LAST PAYMENT AMOUNT INDICATED AS BEING USED*. For example, if you are reporting 1099-INT and you used only Amount Indicator "3" in the Payer/Transmitter "A" Record, then you will only use one ten position payment amount in the Payee "B" Record, right justified, and the First Payee Name Line will begin in position 41. Each payment field that you allow for, or use, must contain 10 numeric characters (see following NOTE). Do not provide a payment amount field when the corresponding Amount Indicator in the Payer/Transmitter "A" Record is blank. Each payment amount must be entered in dollars and cents. Do not enter dollar signs, commas, decimal points, or *NEGATIVE PAYMENTS* (except those items that reflect a loss on Form 1099-B and must be negative overpunched in the units position). Example: If the Amount Indicators are reflected as "123bbb", the Payee "B" Records must have only 3 payment amount fields. If Amount Indicators are reflected as "12367b", the "B" Records must have only 5 payment amount fields. Payment amounts MUST be right-justified and unused positions MUST be zero-filled. NOTE 1: If any one payment amount exceeds "9999999999" (dollars and cents), as many SEPARATE Payee "B" Records as necessary to contain the total amount MUST be submitted for the Payee. NOTE 2: If you file 1099-MISC and use Amount Code "8" in the Amount Indicator field of the Payer/Transmitter "A" Record, you must enter 0000000100 in the corresponding Payment Amount Field. This will not represent an actual money amount;

RECORD NAME: PAYEE "B" RECORD—Continued

Cassette Position	Field Title	Length	Description and Remarks
			this is an amount *code*. (Refer to Part B, Sec. 3, NOTE 1, of the Amount Indicators, Form 1099-MISC, for clarification.)
31-40	Payment Amount 1	10	REQUIRED. This amount is identified by the indicator in position 18 of the Payer/Transmitter "A" Record. *This amount must always be present.*
	Determine at this point the number of payment fields to be reported within the Payee "B" Record. This can be determined from the number of Amount Indicators appearing in positions 18-23 of the Payer/Transmitter "A" Record.		
41-50	Payment Amount 2	10	This amount is identified by the indicator in position 19 of the Payer/Transmitter "A" Record. If position 19 is blank, do not provide for this payment amount.
51-60	Payment Amount 3	10	This amount is identified by the indicator in position 20 of the Payer/Transmitter "A" Record. If position 20 is blank, do not provide for this payment amount.
61-70	Payment Amount 4	10	This amount is identified by the indicator in position 21 of the Payer/Transmitter "A" Record. If position 21 is blank, do not provide for this payment amount.
71-80	Payment Amount 5	10	This amount is identified by the indicator in position 22 of the Payer/Transmitter "A" Record. If position 22 is blank, do not provide for this payment amount.
81-90	Payment Amount 6	10	This amount is identified by the indicator in position 23 of the Payer/Transmitter "A" Record. If position 23 is blank, do not provide for this payment amount.
THE NEXT 160 POSITIONS MUST BEGIN IMMEDIATELY AFTER THE LAST PAYMENT AMOUNT FIELD INDICATED AS BEING USED. THE NUMBER OF PAYMENT AMOUNT FIELDS IS DETERMINED BY THE NUMBER OF AMOUNT INDICATORS IN POSITIONS 18-23 OF THE PAYER/TRANSMITTER "A" RECORD. (See PART B, Sec. 4.01 for an example.)			
Cassette Position	Field Title	Length	Description and Remarks
	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. If you use all payment amounts, the first Payee Name Line will begin in tape position 121. Enter the name of the payee whose taxpayer identification number appears in positions 12-20 above. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 12-20 above. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.

RECORD NAME: PAYEE "B" RECORD—Continued

Cassette Position	Field Title	Length	Description and Remarks
	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than payee's mailing address.
	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in Part A, Sec. 16. Use this field for state information only.
	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.

THE FOLLOWING FIELD DEFINITIONS DESCRIBE PAYEE "B" RECORD POSITIONS FOLLOWING PAYEE CITY, STATE AND ZIP CODE FOR FORMS 1098, 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 1099-R and 5498. FORMS 1099A, 1099-B AND W-2G CANNOT BE FILED ON CASSETTE.

Cassette Position	Field Title	Length	Description and Remarks
	NEXT FIELD AFTER PAYEE CITY, STATE AND ZIP CODE		
-250	Special Data Entries		REQUIRED. This portion of the Payee "B" Record may be used to record information for the payer. The Special Data Entries will begin in positions 201, 211, 221, 231, or 241 depending on the number of payment amounts used in the record. Special Data Entries may be used to make all records the same length; however, the "B" Record may not exceed 256 positions. If this field is not utilized, ENTER BLANKS.
251-256	Blank	6	REQUIRED. Enter blanks.

SEC. 5. END OF PAYEE "C" RECORD

.01 The Control Total fields have been expanded from 12 to 15 positions. Adjust your programs accordingly.

.02 The End of Payer "C" Record is a summary record for a Type of Return for a given payer. It *MUST* be the same length as the "B" Records in the payer's file.

.03 The "C" Record will contain the totals of the payment amount fields and the payees filed by a given payer. The "C" Record must be written after the last payee record for each Type of Return for a given payer. For each "A" Record on the file, there must be a corresponding "C" Record.

.04 Payers/Transmitters must verify the accuracy of the totals in the "C" Record and must enter the totals on the transmittal, Form 4804, which will accompany the shipment.

RECORD NAME: END OF PAYER "C" RECORD

Cassette Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "C".
2-7	Number of Payees	6	REQUIRED. Enter the total number of payees ("B" Records) covered by the preceding Payer/Transmitter "A" Record. Right justify and zero fill.
8-22	Control Total 1	15	REQUIRED. All Control Total fields have been expanded from 12 to 15 positions. Enter accumulated totals from payment Amount 1. Right justify and zero fill. IF LESS THAN NINE AMOUNT FIELDS ARE BEING REPORTED, ZERO FILL UNUSED CONTROL TOTAL FIELDS.
	Control Total 2 through Control Total 6 are OPTIONAL. If any corresponding Payment Amount Fields are present in the Payee "B" Records, accumulate into the appropriate Control Total field. ZERO FILL UNUSED CONTROL TOTAL FIELDS. Please note that all Control Total fields have been expanded from 12 to 15 positions.		
23-37	Control Total 2	15	
38-52	Control Total 3	15	
53-67	Control Total 4	15	
68-82	Control Total 5	15	
83-97	Control Total 6	15	
98-256	Blank	159	REQUIRED. Enter blanks.

SEC. 6. END OF TRANSMISSION "F" RECORD

.01 The "F" Record is a summary of the number of payers and tapes in the entire file.

.02 This record should be written after the last "C" Record.

.03 Only a Tape Mark or a Tape Mark and Trailer Label may follow the "F" Record.

RECORD NAME: END OF TRANSMISSION "F" RECORD

Cassette Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "F".
2-5	Number of Payers	4	Enter total number of payers for this transmission. Right justify and zero fill.
6-8	Number of Reels	3	Enter total number of reels in transmission. Right justify and zero fill.
9-30	Zero	22	REQUIRED. Enter zeroes.
31-256	Blank	226	REQUIRED. Enter blanks.

PART C. BURROUGHS SUPER MINI-DISK SPECIFICATIONS

SECTION 1. GENERAL

.01 The specifications contained in this part of the revenue procedure prescribe the required format and contents of the records to be included in the Burroughs Super Mini-Disk (BSMD) file. These specifications must be adhered to unless deviations have been specifically granted by the Service in writing.

.02 The Service has a Burroughs B-94 mini-computer with 2 mini-disk drives: a Burroughs Super Mini-Disk, style B 9489-11 and a Burroughs Super Mini-Disk II, style B 9489-21.

.03 It is our understanding that most Burroughs B-90 series mini-computers will produce a mini-disk that will be compatible with our system. However, until this is absolutely determined, we request that a test mini-disk be pro-

vided so that we may check for compatibility.

.04 To be compatible a mini-disk must meet the following specifications in total:

(a) The Burroughs Super Mini-Disk is a flexible mylar disk with an iron oxide coating. The disk is 8 inches (20.3 cm) in diameter with a 1.5 inch (3.8 cm) center hole.

(b) There are 32 Sector Markers (holes) in the disk at a distance of 1.5 inches (3.8 cm) from the center. These markers define the 32 sectors in which data can be recorded on each track of the disk.

(c) Recorded data is encoded using the Miller Frequency Mode (MFM) technique. Data transferred between the disk and the processor is encoded using the non return to zero (NRZ) technique.

(d) Bit serial data is written to the disk in the Burroughs standard 180 bytes per sector format.

(e) Number of usable sides is 2.

(f) Tracks per side is 88.

(g) Sectors per track is 32.

(h) Maximum recording density is 4774 bits per inch.

(i) When initializing the mini-disk, the name IRSTAX should be assigned to the mini-disk.

(j) The file name in the super mini-disk header label should be FED-MINI.

.05 Payers who can substantially conform to these specifications, but who require some minor deviations, MUST contact the Magnetic Media Coordinator at the National Computer Center or the service centers. Under no circumstances may mini-disks deviating from the specifications in this revenue procedure be submitted without prior written approval from IRS. If you file under the Combined Federal/State Program, your files must conform totally to this revenue procedure.

.06 An external label must appear on each mini-disk submitted for processing. The following information is needed:

(a) The transmitter's name.

(b) The five character Transmitter Control Code.

(c) The type of computer equipment that the data was prepared on.

(d) The type of drive utilized.

(e) The tax year of the data (e.g., 1985).

(f) Document types (e.g., 1099 INT).

(g) The total number of payers (from the "F" record).

(h) The total number of payees (from the "C" record).

(i) The total number of mini-disks in the file.

(j) A mini-disk number assigned by the transmitter.

(k) The sequence of each mini-disk (e.g., 001 of 008).

This information will assist IRS in processing the file or in locating a file, should the transmitter request that it be returned due to errors. IRS advises that special shipping containers not be used for transmitting data since it cannot be guaranteed that they will be returned.

SEC. 2. PAYER/TRANSMITTER "A" RECORD

.01 Identifies the payer and transmitter of the mini-disk and provides parameters for the succeeding Payee "B" Records. IRS computer programs rely on the absolute relationship between the parameters and data fields in the "A" Record and the data fields in the "B" Records to which they apply.

.02 The number of "A" Records appearing on a mini-disk will depend on the number of payers and the different types of returns being reported. After the header label on the mini-disk, the first record appearing in the file must be an "A" Record. For mini-disk filing, the *actual* record lengths for the "A" and "B" Records must agree with whatever is entered in mini-disk positions 29-31 and 32-34 of the "A" Record. A transmitter may include Payee "B" records for more than one payer on a mini-disk; however, each GROUP of Payee "B" Records must be preceded by an "A" Record. A single mini-disk may also contain different types of returns, but the types of returns *must* not be intermingled. A separate "A" Record is required for each type of return being reported. The initial record on a *file* must be an "A" Record.

RECORD NAME: PAYER/TRANSMITTER "A" RECORD

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1			
1	Record Sequence	1	REQUIRED. Must be a "1". It is used to sequence the sectors making up a Service Record.
2	Record Type	1	REQUIRED. Enter "A". Must be the second position of each PAYER/TRANSMITTER Record.
3	Payment Year	1	REQUIRED. Must be the right most digit of the year for which information is being reported (e.g., if payments were made in 1985, enter "5"). Must be incremented each year.
4-6	Mini-Disk Sequence Number	3	REQUIRED. Sequence number assigned by the Transmitter to each mini-disk starting with 001.
7-15	Payer's Federal EIN	9	REQUIRED. Must be the *valid* 9-digit number assigned to the payer by IRS. DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROES.

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
16	Blank	1	REQUIRED. Enter blank.
17	Combined Federal/State Filer	1	REQUIRED. Enter the appropriate code from the table below. *Prior approval* is required. A Consent Form 6847 *must* be submitted to IRS before tax information will be released to the states. Refer to Part A, Sec. 14.11 for money criteria. Not all states participate in this Program. If the Payer/Transmitter is not participating in the Combined Federal/State Program, enter blanks. (Refer to Part A, Sec. 14 for the requirements that *must* be met *prior* to actual participation in this program.) Forms 1098, 1099-A, 1099-B and W-2G cannot be filed on this Program. *Code* — *Meaning* 1 — Participating in the Combined Federal/State Filing Program blank — Not participating
18	Type of Return	1	REQUIRED. Enter appropriate code from table below: *Type of Return* — *Code* 1098 — 3 1099-A — 4 1099-B — B 1099-DIV — 1 1099-G — F 1099-INT — 6 1099-MISC — A 1099-OID — D 1099-PATR — 7 1099-R — 9 5498 — L W-2G — W
19-27	Amount Indicators	9	REQUIRED. In most cases, the boxes or Amount Indicators on paper information returns correspond with the Amount Codes used to file on magnetic media; however, should you notice discrepancies, please disregard them and program according to this revenue procedure for your returns filed on magnetic media. The amount indicators entered for a given type of return indicate type(s) of payment(s) which were made. Example: If position 18 of the Payer/Transmitter "A" Record is "6" (for 1099-INT) and positions 19-27 are "123bbbbbb," this indicates that 3 payment amount fields are present in all of the following Payee "B" Records. The first payment amount field in the Payee "B" Record will represent Earnings from savings and loan associations, credit unions, bank deposits, bearer certificates of deposit, etc., the second will represent Amount of forfeiture, and the third will represent Federal income tax withheld. Enter the Amount Indicators in ASCENDING SEQUENCE, left justify, filling unused positions with blanks. For any further clarification of the Amount Indicator codes, you may contact the service center or National Computer Center Magnetic Media Coordinators listed in Part A, Sec. 13.

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
	Amount Indicators Form 1098—Mortgage Interest Statement (New Form)		For Reporting Mortgage Interest Received from Payer(s) on Form 1098: Amount Code — Amount Type 1 — Mortgage interest received from payer(s) (see NOTE) 2 — Mortgage interest credit 3 — Optional field for items such as real estate taxes or insurance paid from escrow
	Amount Indicators Form 1099-A—Acquisition or Abandonment of Secured Property (New Form)		For Reporting the Acquisition or Abandonment of Secured Property on Form 1099-A: Amount Code — Amount type 2 — Amount of debt outstanding 3 — Amount of debt satisfied 4 — Fair market value of property at acquisition or abandonment
	Amount Indicators Form 1099-B—Proceeds from Broker and Barter Exchange Transactions		For Reporting Payments on Form 1099-B: Amount Code — Amount Type 2 — Stocks, bonds, etc. (For Forward Contracts see NOTE below.) 3 — Bartering 4 — Federal income tax withheld 6 — Profit or loss realized in 1985 7 — Unrealized profit (or loss) on open contracts—12/31/84 8 — Unrealized profit (or loss) on open contracts—12/31/85 9 — Aggregate profit (or loss) NOTE: The Payment Amount field associated with Amount Code 2 may be used to represent a loss when the reporting is for Forward Contracts. Refer to Payee "B" Record-General Field Descriptions, Payment Amount Fields, for instructions in reporting negative amounts.
	Amount Indicators From 1099-DIV—Dividends and Distributions		For Reporting Payments on Form 1099-DIV: Amount Code — Amount Type 1 — Gross dividends and other distributions on stock 2 — Dividends qualifying for exclusion 3 — Dividends not qualifying for exclusion 4 — Federal income tax withheld 5 — Capital gain distributions 6 — Nontaxable distributions (if determinable) 7 — Foreign tax paid 8 — Cash liquidation distributions 9 — Noncash liquidation distributions (Show fair market value)

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
	Amount Indicators Form 1099-G—Certain Government Payments		For Reporting Payments on Form 1099-G: Amount Code — Amount Type 1 — Unemployment compensation 2 — State or local income tax refunds (see NOTE) 4 — Federal income tax withheld 5 — Discharge of indebtedness 6 — Taxable grants 7 — Agriculture payments
	Amount Indicators Form 1099-INT—Interest Income		For Reporting Payments on Form 1099-INT: Amount Code — Amount Type 1 — Earnings from savings and loan associations, credit unions, bank deposits, bearer certificates of deposit, etc. 2 — Amount of forfeiture 3 — Federal income tax withheld 4 — Foreign tax paid (if eligible for foreign tax credit) 5 — U.S. Savings Bonds, etc.
	Amount Indicators Form 1099-MISC—Miscellaneous Income (See Notes 1, 2 and 3)		For Reporting Payments on Form 1099-MISC: Amount Code — Amount Type 1 — Rents 2 — Royalties 3 — Prizes and awards 4 — Federal income tax withheld 5 — Fishing boat proceeds 6 — Medical and health care payments 7 — Nonemployee compensation 8 — Direct sales *"indicator"* (see NOTE 1) 9 — Substitute payments in lieu of dividends or interest (see NOTE 2)

NOTE 1: Use Amount Code "8" to report *direct sales* of $5000 or more of consumer products on a buy-sell, deposit-commission, or other basis *for resale*. If *not* for resale, enter a "0" (zero) in mini-disk position 4 of the Payee "B" Record. Please refer to the "B" Record Document Specific Code for clarification. The use of Amount Code "8" actually reflects an *indicator* of *direct sales* and not an actual payment amount or amount code. The corresponding payment amount field in the Payee "B" record MUST be reflected as 0000000100. This does not mean that a payment of $1.00 was made or is being reported. The use of Amount Code "8" relates directly to mini-disk position 5, Document Specific Code and Note 2 of the Payment Amount Field in the Payee "B" Record.

NOTE 2: Brokers are subject to a new reporting requirement for payments received after 1984. Brokers who transfer securities of a customer for use in a short sale must use Amount Code 9 of Form 1099-MISC to report the aggregate payments received in lieu of dividends or tax-exempt interest on behalf of a customer while the short sale was open. Generally, for substitute payments in lieu of dividends, a broker is required to file a Form 1099-MISC for each affected customer who is *not* an individual. Refer to the 1985 "Instructions for Form 1099 Series, 1098, 5498, and 1096" for detailed information. (The instructions are available from local IRS offices.)

Mini-Disk Position	Field Title	Length	Description and Remarks

SECTOR 1 (Continued)

NOTE 3: If you are reporting Excess Golden Parachute Payments, use paper forms 1099-MISC. Do not report Excess golden parachute Payments on magnetic media for tax year 1985. See Part A, Sec. 15 for a definition of an Excess Golden Parachute Payment.

Amount Indicators Form 1099-OID—Original Issue Discount

For Reporting Payments on Form 1099-OID:

Amount Code	Amount Type
1	Total original issue document (ratable) for the tax year covered by the return
2	Stated interest (the regular interest paid on this obligation without regard to any original issue discount)
3	Amount of forfeiture
4	Federal income tax withheld

Amount Indicators Form 1099-PATR—Taxable Distributions Received From Cooperatives

For Reporting Payment on Form 1099-PATR:

Amount Code	Amount Type
1	Patronage dividends
2	Nonpatronage distributions
3	Per-unit retain allocations
4	Federal income tax withheld
5	Redemption of nonqualified notices and retain allocations
6	Investment credit (See NOTE)
7	Energy investment credit (see NOTE)
8	Jobs credit (See NOTE)

NOTE: The amounts shown for Amount Indicators "6", "7" and "8" must be reported to the payee; however, since these amounts are not taxable, they need not be reported to IRS.

Amount Indicators Form 1099-R—Total Distributions from Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, Etc. (See NOTE)

For Reporting Payments on Form 1099-R:

Amount Code	Amount Type
1	Amount includable as income (add amounts in codes 2 and 3)
2	Capital gain (for lump-sum distributions only)
3	Ordinary income
4	Federal income tax withheld
5	Employee contributions to profit-sharing or retirement plans
6	IRA, SEP or DEC distributions
8	Net unrealized appreciation in employer's securities
9	Other

NOTE: For tax year 1985 reporting, coding is not provided to report to IRS, on magnetic media, any state income tax withheld.

Amount Indicators Form 5498—Individual Retirement Arrangement Information

For Reporting Payments on Form 5498:

Amount Code	Amount Type
1	Regular IRA, SEP or DEC contributions made in

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			calendar year 1985 for tax year 1984 reporting 2 Rollover IRA, SEP or DEC contributions 3 Regular IRA, SEP or DEC contributions made in calendar year 1985 and 1986 for tax year 1985 reporting 4 Allocable life insurance cost included in code 3 for endowment contracts only
	Amount Indicators Form W-2G—Certain Gambling Winnings		For Reporting Payments on Form W-2G: Amount Code — Amount Type 1 — Gross winnings 2 — Federal income tax withheld 7 — Winnings from identical wagers
28	Blank	1	REQUIRED. Enter blank.
29-31	"A" Record Length	3	REQUIRED. This indicates the Record Length, *NOT* the Sector Length. Enter the number of positions used or that you have allowed for the "A" Record. For mini-disk filing, the "actual" record length *must* agree with whatever you enter in this field.
32-34	"B" Record Length	3	REQUIRED. This indicates the Record Length, *NOT* the Sector Length. Enter the number of positions used or that you have allowed for the "B" Record. For mini-disk filing, the "actual" record length *must* agree with whatever you enter in this field.
35	Blank	1	REQUIRED. Enter blank.
36-40	Transmitter Control Code (TCC)	5	REQUIRED. Enter the 5 character Transmitter Control Code assigned by IRS. See Part A, Sec. 15 for a definition of Transmitter Control Code (TCC). You must have a TCC to file *actual* data on this program.
41	Blank	1	REQUIRED. Enter blank.
42-81	First Payer Name	40	REQUIRED. Enter the name of the payer in the manner in which it is used in normal business. Any extraneous information must be deleted from the name line. Left justify and fill with blanks.
82-120	Second Payer Name	39	REQUIRED. The contents of this field are dependent upon the TRANSFER AGENT INDICATOR in position 121 of this record. If the Transfer Agent Indicator contains a "1", this Field will contain the name of the Transfer Agent. If the Transfer Agent Indicator contains a "0" (zero), this field will contain either a continuation of the First Payer Name field or blanks. Left justify and fill unused positions with blanks. IF NO ENTRIES ARE PRESENT FOR THIS FIELD FILL WITH BLANKS. (See Part A, Sec. 15 for a definition of Transfer Agent.)
121	Transfer Agent Indicator	1	REQUIRED. Identifies the entity in the Second Payer Name Field. (See Part A, Sec. 15 for a definition of Transfer Agent.)

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			Code / *Meaning* 1 — The entity in the Second Payer Name field is the Transfer Agent. 0 (zero) — The entity shown is *not* the Transfer Agent (i.e. the Second Payer Name field contains either a continuation of the First Payer Name field or blanks).
122-180	Blank	59	REQUIRED. Enter blanks.

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service Record.
2	Record Type	1	REQUIRED. Enter "A". Must be the second position of each PAYER/TRANSMITTER Record.
3-42	Payer Shipping Address	40	REQUIRED. If the TRANSFER AGENT INDICATOR in position 121 of Sector 1 is a "1" enter the shipping address of the Transfer Agent. Otherwise, enter the shipping address of the payer. Left justify and fill with blanks.
43-82	Payer City, State and ZIP Code	40	REQUIRED. If the TRANSFER AGENT INDICATOR in position 121 of Sector 1 is a "1" enter the city, state and ZIP Code of the Transfer Agent. Otherwise, enter the city, state and ZIP Code of the payer. Left justify and fill with blanks.
83-180	Blank	98	REQUIRED. Enter blanks.

ADDITIONALLY, IF THE PAYER AND THE TRANSMITTER ARE THE SAME, THE "A" RECORD MAY BE TERMINATED WITH SECTOR 2 AS DESCRIBED ABOVE. HOWEVER, IF THE PAYER AND THE TRANSMITTER ARE NOT THE SAME OR THE TRANSMITTER INCLUDES FILES FOR MORE THAN ONE PAYER OR THIS IS A COMBINED FEDERAL/STATE FILING PAYER, THE FOLLOWING ITEMS ARE REQUIRED.

83-122	First Name line of Transmitter	40	REQUIRED. Enter the name of the transmitter in the manner in which it is used in normal business. The name of the transmitter *must* be constant through the entire file. Left justify and fill with blanks.
123-180	Blank	58	REQUIRED. Enter blanks.

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be a "3". Used to sequence the sectors making a Service Record.
2	Record Type	1	REQUIRED. Enter "A". Must be the second position of each PAYER/TRANSMITTER Record.

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
3-42	Second Name Line of Transmitter	40	REQUIRED. Enter the second name line of the transmitter. Left justify and fill with blanks. IF NO ENTRIES ARE PRESENT FOR THIS FIELD FILL WITH BLANKS.
43-82	Transmitter Mailing Address	40	REQUIRED. Enter the mailing address of the transmitter. Left justify and fill with blanks.
83-122	Transmitter City, State and ZIP Code	40	REQUIRED. Enter the city, state and ZIP Code of the transmitter. Left justify and fill with blanks.
123-180	Blank	58	REQUIRED. Enter blanks.

SEC. 3. PAYER/TRANSMITTER "A" RECORD—RECORD LAYOUT

PAYER/TRANSMITTER "A" RECORD—RECORD LAYOUT

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	MINI-DISK SEQUENCE NUMBER	PAYER'S FEDERAL EIN	BLANK	COMBINED FEDERAL/STATE FILER	TYPE OF RETURN
1	2	3	4—6	7—15	16	17	18

Sector 1 (Continued)

AMOUNT INDICATORS	BLANK	"A" RECORD LENGTH	"B" RECORD LENGTH	BLANK
19—27	28	29—31	32—34	35

Sector 1 (Continued)

TRANSMITTER CONTROL CODE	BLANK	FIRST PAYER NAME	SECOND PAYER NAME	TRANSFER AGENT INDICATOR	BLANK
36—40	41	42—81	82—120	121	122—180

Sector 2

RECORD SEQUENCE	RECORD TYPE	PAYER SHIPPING ADDRESS	PAYER CITY, STATE AND ZIP CODE	BLANK
1	2	3—42	43—82	83—180

IF THE PAYER AND THE TRANSMITTER ARE THE SAME, THE "A" RECORD MAY BE TERMINATED WITH SECTOR 2 AS ILLUSTRATED ABOVE. HOWEVER, IF THE PAYER AND THE TRANSMITTER ARE NOT THE SAME, OR THE TRANSMITTER INCLUDES FILES FOR MORE THAN ONE PAYER OR THIS IS A COMBINED FEDERAL/STATE PAYER, THE FOLLOWING ITEMS ARE REQUIRED.

Sector 2 RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

RECORD SEQUENCE	RECORD TYPE	PAYER SHIPPING ADDRESS	PAYER CITY, STATE AND ZIP CODE	FIRST NAME LINE OF TRANSMITTER	BLANK
1	2	3—42	43—82	83—122	123—180

Sector 3

RECORD SEQUENCE	RECORD TYPE	SECOND NAME LINE OF TRANSMITTER	TRANSMITTER MAILING ADDRESS	TRANSMITTER CITY, STATE AND ZIP CODE	BLANK
1	2	3—42	43—82	83—122	123—180

SEC. 4. PAYEE "B" RECORDS—GENERAL INFORMATION FOR ALL FORMS

.01 This section contains the general information concerning the Payee "B" Record for all information returns. For detailed descriptions of the record refer to the following:

(a) Sec. 5. PAYEE "B" RECORDS—FIELD DESCRIPTIONS FOR FORMS 1098, 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 1099-R and 5498.

(b) Sec. 7. PAYEE "B" RECORDS—FIELD DESCRIPTIONS FOR FORM 1099-A.

(c) Sec. 9. PAYEE "B" RECORDS—FIELD DESCRIPTIONS FOR FORM 1099-B.

(d) Sec. 11. PAYEE "B" RECORDS—FIELD DESCRIPTIONS FOR FORM W-2G.

.02 The Payee "B" Record contains the payment information from the individual statements. When filing information documents on mini-disk(s), the format for the Payee "B" Records will vary in relation to the number of payment amount fields being reported. The number of payment amount fields will depend upon the number of Payment Amount Indicator Codes used in positions 19-27 of the Payer/Transmitter "A" Record. For example, if you are reporting 1099-INT, position 18 of the Payer/Transmitter "A" Record will be coded with a "6." If the Amount Indicators used to report this interest are Amount Codes "1," "2," and "3," then mini-disk positions 19-27 of the "A" Record will be coded "123bbbbbb" (b represents a *blank* position). To correspond with Amount Indicators "1," "2," and "3" of the "A" Record, the "B" Record will contain three payment amount fields. Mini-disk positions 32-41 of the Payee "B" Record will contain the payment amount to be reported for Amount Code "1" (earnings from savings and loan associations, credit unions, bank deposits, bearer certificates of deposits, etc.); mini-disk positions 42-51 of the "B" Record would contain the payment amount to be reported for Amount Code "2" (amount of forfeiture); and mini-disk positions 52-61 of the "B" Record would contain the payment amount to be reported for Amount Code "3" (Federal income tax withheld). The First Payee Name Line *must* begin immediately after the last payment amount *that is used*. In this example, the First Payee Name Line would begin in mini-disk position 61.

.03 All payee records *must contain correct payee name and address information* entered in the fields prescribed in this section. Any records containing an invalid TIN (SSN or EIN) and having no address data present will be returned for correction.

.04 IRS must be able to identify the surname associated with the TIN (SSN or EIN) furnished on a statement. The specifications below include a field in the payee records called "Name Control" in which the first four alphabetic characters of the payees' surname or last name are to be entered by the payers. The surname or last name should appear first in the First Payee Name Line of all Payee "B" Records; however, if your records have been developed using the first name first, IRS programs will accept this but, a blank must appear between the first and last name.

.05 If payers are unable to provide the first four characters of the surname, the Name Control Field may be left blank; however, compliance with the following will facilitate IRS computer programs in generating the Name Control.

(a) The surname of the payee whose TIN (SSN or EIN) is shown in the Payee "B" Record should always appear first. If however, you enter the first name first, you must leave a blank space between the first and last name.

(b) In the case of multiple payees, only the surname of the payee whose TIN (SSN or EIN) is shown in the Payee "B" Record, must be present in the First Payee Name Line. Surnames of any other payees in the record must be entered in the Second Payee Name Line.

.06 Provision is also made in these specifications for data entries required by state or local governments. This should minimize the Payer/Transmitter's programming burden should payers desire to report on tape to state or local governments. See Part A, Sec. 14, for the Combined Federal/State filing requirements.

.07 Those filers participating in the Combined Federal/State Filing Program *must* have 180 position sectors. Positions 127 and 128 in the Payee "B" Record Sector 2 or 3 *must* contain the appropriate state code for the state to receive the information. The file should also meet the money criteria described in Part A, Sec. 14.11. Do not code for the states unless prior approval to participate has been granted by IRS. See

Part A, Sec. 14 for a list of the valid participating state codes. *FORMS 1098, 1099-A, 1099-B AND W-2G CANNOT BE FILED UNDER THE COMBINED FEDERAL/STATE FILING PROGRAM.* Your files must meet all of the requirements specified in Part A, Sec. 14 in order to participate in this program.

SEC. 5 PAYEE "B" RECORDS—FIELD DESCRIPTIONS FOR FORMS 1098, 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 1099-R AND 5498

.01 This section contains the general payment information from individual statements for Forms 1098, 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 1099-R and 5498.

.02 In most instances each Payee "B" Record described in this section will be composed of two sectors on the mini-disk positions 1-41 being a constant format and the variance occurring in positions 42-180 of the first sector and the entire second sector. In those instances where six or more payment amount fields are reported, each Payee "B" Record will be composed of three sectors on the mini-disk with positions 1-41 of the first sector being a constant format and the variance occurring in positions 42-180 of the first sector and the entire second and third sectors.

RECORD NAME: PAYEE "B" RECORD

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1			
1	Record Sequence	1	REQUIRED. Must be a "1". It is used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-4	Payment Year	2	REQUIRED. Must be the last two digits of the year for which payments are being reported (e.g., if payments were made in 1985 enter "85"). Must be incremented each year.
5	Document Specific Code	1	REQUIRED for Forms 1099-R, 1099-MISC, and 1099-G. For *Form 1099-R*, enter the appropriate value for the Category of total IRA Distribution. For *Form 1099-MISC*, enter the appropriate value for Direct Sales. For *Form 1099-G*, enter the year of income tax refund. FOR ALL OTHER FORMS, ENTER BLANK.
	Category of Total Distribution (Form 1099-R only)		Use only for reporting on *Form 1099-R* to identify the Category of Total Distribution. Enter the applicable code from the table below. Code 7 below is *not required* for Amount Indicators 1, 2 and 3. "0" (zero) is not a valid code for Form 1099-R. *Category* — *Code* Premature distribution (other than codes 2, 3, 4, or 5) — 1 Rollover — 2 Disability — 3 Death — 4 Prohibited transaction — 5 Other — 6 Normal IRA, SEP or DEC distributions — 7 Excess contributions refunded plus earnings on such excess contributions — 8
	Direct Sales (Form 1099-MISC only)		Use only for direct sales reporting on *Form 1099-MISC*. If sale to the recipient of consumer products on a buy-sell, deposit commission, or any other basis for resale, have amounted t $5,000 or more, ENTER "1". If not for resale, enter "0" (zero) If you are filing 1099-MISC, with an Amount Indicator of "8" i the "A" Record, you must enter a code "1" or "0" in this field

RECORD NAME: PAYEE "B" RECORD—Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			In Part B, Sec. 4, information concerning the direct sales indicator can be found under Amount Indicators, Form 1099-MISC, NOTE 1.
	Refund is for Tax Year (Form 1099-G only)		Use only for reporting the tax year for which the refund was issued. If the payment amount field associated with Amount Indicator 2, Income Tax Refunds, contains a refund, credit or offset that is attributable to an income tax which applies exclusively to income from a trade or business and is not of general application, then enter the ALPHA equivalent of the year of refund from the table below. Otherwise, enter the NUMERIC Year for which the Refund was issued.

Years for which Refund was Issued	Alpha Equivalent
1	A
2	B
3	C
4	D
5	E
6	F
7	G
8	H
9	I
0	J

6-7	Blank	2	REQUIRED. Enter blanks. (Reserved for IRS use). Mini-Disk position 6 is used to indicate a corrected return. Refer to Part A, Sec. 10 for specific instructions on how to file corrected returns using either magnetic media or paper forms.
8-11	Name Control	4	REQUIRED. Enter the first 4 letters of the surname of the payee. Surnames of less than four (4) letters should be left justified, filling the unused positions with blanks. Special characters and imbedded blanks should be removed. IF THE NAME CONTROL IS NOT DETERMINABLE BY THE PAYER, LEAVE THIS FIELD BLANK. A dash (–) or ampersand (&) are the only acceptable special characters.
12	Type of TIN	1	REQUIRED. This field is used to identify the Taxpayer Identification Number (TIN) in positions 13-21 as either an Employer Identification Number, a Social Security Number, or the reason no number is shown. Enter the appropriate code from the table below:

Type of TIN	*TIN*	*Type of Account*
1	EIN	A business or an organization
2	SSN	An individual
9	SSN	The payee is a foreign individual and not a U.S. resident
blank	N/A	A Taxpayer Identification Number is required but unobtainable due to legitimate cause; e.g. number applied for but not received.

RECORD NAME: PAYEE "B" RECORD—Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
13-21	Taxpayer Identification Number	9	REQUIRED. Enter the valid 9-digit Taxpayer Identification Number of the payee (SSN or EIN, as appropriate). Where an identification number has been applied for but not received or where there is any other legitimate cause for not having an identification number, *enter blanks*. *DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROS*. Any record containing an invalid identification number in this field will be returned for correction.
22-31	Payer's Account Number for Payee	10	REQUIRED. Payer may use this field to enter the payee's account number. The use of this item will facilitate easy reference to specific records in the payer's file should any questions arise. DO NOT ENTER A TAXPAYER IDENTIFICATION NUMBER IN THIS FIELD. An account number can be any account number assigned by the payer to the payee (i.e., checking account, savings account, etc.). THIS NUMBER WILL HELP TO DISTINGUISH THE INDIVIDUAL PAYEE'S ACCOUNT WITH YOU AND THE SPECIFIC TRANSACTION MADE WITH THE ORGANIZATION, SHOULD MULTIPLE RETURNS BE FILED. This information will be particularly necessary if you need to file a corrected return. You are strongly encouraged to use this field. You may use any number that will help identify the particular transaction that you are reporting.
	Payment Amount Fields		The number of payment amounts is dependent upon and must agree with the number of Amount Indicators present in positions 19-27 of Sector 1 of the "A" Record. *THE FIRST PAYEE NAME LINE MUST APPEAR IMMEDIATELY AFTER THE LAST PAYMENT AMOUNT INDICATED AS BEING USED*. For example, if you are reporting 1099-INT and you used only Amount Indicator "3" in the Payer/Transmitter "A" Record, then you will only use one ten position payment amount in the Payee "B" Record, right justified, and the First Payee Name Line will begin in position 42. Each payment field that you allow for, or use, must contain 10 numeric characters (see following NOTE). Do not provide a payment amount field when the corresponding Amount Indicator in the Payer/Transmitter "A" Record is blank. Each payment amount must be entered in dollars and cents. Do not enter dollar signs, commas, decimal points, or *NEGATIVE PAYMENTS* (except those items that reflect a loss on Form 1099-B and must be negative overpunched in the units position). Example: If the Amount Indicators are reflected as "123bbbbbb", the Payee "B" Records must have only 3 payment amount fields. If Amount Indicators are reflected as "12367bbbb", the "B" Records must have only 5 payment amount fields. Payment amounts MUST be right-justified and unused positions MUST be zero-filled. NOTE 1: If any one payment amount exceeds "9999999999" (dollars and cents), as many SEPARATE Payee "B" Records as necessary to contain the total amount MUST be submitted for the Payee. NOTE 2: If you file 1099-MISC and use Amount Code "8" in the Amount Indicator field of the Payer/Transmitter "A" Record

RECORD NAME: PAYEE "B" RECORD—Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			you must enter 0000000100 in the corresponding Payment Amount Field. This will not represent an actual money amount; this is an amount *code*. (Refer to Part C, Sec. 2, NOTE 1, of the Amount Indicators, Form 1099-MISC, for clarification.)
32-41	Payment Amount 1	10	REQUIRED. This amount is identified by the indicator in position 19, Sector 1, of the Payer/Transmitter "A" Record. *This amount must always be present.*
	Determine at this point the number of payment fields to be reported within the Payee "B" Record. This can be determined from the number of Amount Indicators appearing in positions 19-27 of Sector 1 of the Payer/Transmitter "A" Record. Following are the formats for completing positions 42-180 of SECTOR 1, positions 1-180 of SECTOR 2 and positions 1-180 of SECTOR 3 of the Payee "B" Record. Use the appropriate format as required.		
42-81	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear immediately after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 of SECTOR 1. If fewer than 40 characters are required, left justify aand fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose Taxpayer Identification Number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.

RECORD NAME: PAYEE "B" RECORD (USING ONE PAYMENT FIELD)

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
82-121	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payee's *names* who are not associated with the taxpayer identification number in positions 13-21 of SECTOR 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
122-180	Blank	59	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING ONE PAYMENT FIELD)—Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
43-71	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible).
72-73	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
74-82	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code only.
83-126	Blank	44	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program enter the valid state code from Part A, Sec. 14.10. For those states *NOT* participating in this program or for Form 1098 ENTER BLANKS.
129-180	Blank	52	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position Sector 1, of the Payer/Transmitter "A" Record.
52-91	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after last payment amount indicated as being *used*. Do not enter *dress* information in this field. Enter the name of the pa whose taxpayer identification number appears in positions 1

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)—Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
92-180	Blank	89	REQUIRED. Enter blanks.

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the taxpayer identification number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
123-126	Blank	4	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program,

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)—Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
			enter the valid state code from PART A, SEC. 14.10. For those states NOT participating in this program or for Form 1098 ENTER BLANKS.
129-180	Blank	52	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20 Sector 1 of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21 Sector 1 of the Payer/Transmitter "A" Record.
62-101	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after th last payment amount indicated as being *used*. Do not enter *ad dress* information in this field. Enter the name of the paye whose Taxpayer Identification Number appears in position 13-21 of Sector 1. If fewer than 40 characters are required, le justify and fill unused positions with blanks. If more space is r quired *for the name*, utilize the Second Payee Name Line fie below. If there are multiple payees, *only the name* of the pay whose taxpayer identification number has been provided shou be entered in this field. The names of the other payees should entered in the Second Payee Name Line field.
102-180	Blank	79	REQUIRED. Enter blanks.

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors ma ing up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of ea PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than available in the First Payee Name Line, enter the remaini portion of the name *only* in this field. If there are multiple p ees, this field may be used for those payees' *names* who are associated with the taxpayer identification number in positi 13-21 of Sector 1. Do not enter address information in this fi Left justify and fill unused positions with blanks. FILL WI BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIEL

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)—Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
123-126	Blank	4	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 14.10. For those states NOT participating in this program or for Form 1098 ENTER BLANKS.
129-180	Blank	52	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING FOUR PAYMENT FIELDS)

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1, of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1, of the Payer/Transmitter "A" Record.
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position 22, Sector 1, of the Payer/Transmitter "A" Record.
72-111	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below.

RECORD NAME: PAYEE "B" RECORD (USING FOUR PAYMENT FIELDS)—Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			If there are multiple payees, *only the name* of the payee wh taxpayer identification number has been provided should be tered in this field. The names of the other payees should be tered in the Second Payee Name Line field.
112-180	Blank	69	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be "2". Used to sequence the sectors ma up a Service PAYEE Record.
2	Record Type	1	REQURED. Enter "B". Must be the second position of PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space th available in the First Payee Name Line, enter the remai portion of the name *only* in this field. If there are multiple ees, this field may be used for those payees' *names* who ar associated with the Taxpayer Identification Number in posi 13-21 of Sector 1. Do not enter address information in this Left justify and fill unused positions with blanks. FILL W BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FI
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify fill unused positions with blanks. Address MUST be pre This field MUST NOT contain any data other than payee's ing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unuse sitions with blanks. Do *not* enter state and ZIP Code inform in this field. (If the payee lives outside of the United State clude their current mailing address and spell out the name country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You M use valid U.S. Postal Service abbreviations for states as s in the table in Part A, Sec. 16. Use this field for state inf tion *only*.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned U.S. Postal Service. If only the first 5 digits are known, le tify and fill the unused positions with blanks. Use this fi the ZIP code *only*.
123-126	Blank	4	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to agency as part of the Combined Federal/State Filing Pro enter the valid state code from Part A, Sec. 14.10. For states NOT participating in this program or for Form 109 TER BLANKS.
129-180	Blank	52	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING FIVE PAYMENT FIELDS)

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1, of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1, of the Payer/Transmitter "A" Record.
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position 22, Sector 1, of the Payer/Transmitter "A" Record.
72-81	Payment Amount 5	10	This amount is identified by the amount indicator in position 23, Sector 1, of the Payer/Transmitter "A" Record.
82-121	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line below. If there are multiple payees, *only the name* of the payee whose Taxpayer Identification Number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
122-180	Blank	59	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)

RECORD NAME: PAYEE "B" RECORD (USING FIVE PAYMENT FIELDS)-Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
123-126	Blank	4	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 14.10. For those states NOT participating in this program or for Form 1098 ENTER BLANKS.
129-180	Blank	52	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING SIX PAYMENT FIELDS)

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20 Sector 1 of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21 Sector 1 of the Payer/Transmitter "A" Record.
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position 22 Sector 1 of the Payer/Transmitter "A" Record.
72-81	Payment Amount 5	10	This amount is identified by the amount indicator in position 23 Sector 1 of the Payer/Transmitter "A" Record.
82-91	Payment Amount 6	10	This amount is identified by the amount indicator in position 24 Sector 1 of the Payer/Transmitter "A" Record.
92-180	Blank	89	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors m ing up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of e PAYEE Record.

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
3-42	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose Taxpayer Identification Number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
43-82	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
83-122	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
123-180	Blank	58	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be a "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-31	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
32-33	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
34-42	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
43-126	Blank	84	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING SIX PAYMENT FIELDS)—Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 14.10. For those states NOT participating in this program or for Form 1098 ENTER BLANKS.
129-180	Blank	52	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING SEVEN PAYMENT FIELDS)

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1 of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1 of the Payer/Transmitter "A" Record.
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position 22, Sector 1 of the Payer/Transmitter "A" Record.
72-81	Payment Amount 5	10	This amount is identified by the amount indicator in position 23, Sector 1 of the Payer/Transmitter "A" Record.
82-91	Payment Amount 6	10	This amount is identified by the amount indicator in position 24, Sector 1 of the Payer/Transmitter "A" Record.
92-101	Payment Amount 7	10	This amount is identified by the amount indicator in position 25, Sector 1 of the Payer/Transmitter "A" Record.
102-180	Blank	79	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose Taxpayer Identification Number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.

RECORD NAME: PAYEE "B" RECORD (USING SEVEN PAYMENT FIELDS)—Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
43-82	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
83-122	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
123-180	Blank	58	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be a "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-31	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
32-33	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
34-42	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
43-126	Blank	84	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to a state agency as part of Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 14.10. For those states NOT participating in this program or for Form 1098 ENTER BLANKS.
129-180	Blank	52	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING EIGHT PAYMENT FIELDS)

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1 of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1 of the Payer/Transmitter "A" Record.
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position 22, Sector 1 of the Payer/Transmitter "A" Record.
72-81	Payment Amount 5	10	This amount is identified by the amount indicator in position 23, Sector 1 of the Payer/Transmitter "A" Record.
82-91	Payment Amount 6	10	This amount is identified by the amount indicator in position 24, Sector 1 of the Payer/Transmitter "A" Record.
92-101	Payment Amount 7	10	This amount is identified by the amount indicator in position 25, Sector 1 of the Payer/Transmitter "A" Record.
102-111	Payment Amount 8	10	This amount is identified by the amount indicator in position 26, Sector 1 of the Payer/Transmitter "A" Record.
112-180	Blank	69	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose Taxpayer Identification Number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
43-82	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.

RECORD NAME: PAYEE "B" RECORD (USING EIGHT PAYMENT FIELDS)—Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
83-122	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
123-180	Blank	58	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be a "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B." Must be the second position of each PAYEE Record.
3-31	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
32-33	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
34-42	Payee ZIP CODE	9	REQUIRED, Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
43-126	Blank	84	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 14.10. For those states NOT participating in this program or for Form 1098 ENTER BLANKS.
129-180	Blank	52	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING NINE PAYMENT FIELDS)

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1 of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1 of the Payer/Transmitter "A" Record.

RECORD NAME: PAYEE "B" RECORD (USING NINE PAYMENT FIELDS)—Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position 22, Sector 1 of the Payer/Transmitter "A" Record.
72-81	Payment Amount 5	10	This amount is identified by the amount indicator in position 23, Sector 1 of the Payer/Transmitter "A" Record.
82-91	Payment Amount 6	10	This amount is identified by the amount indicator in position 24, Sector 1 of the Payer/Transmitter "A" Record.
92-101	Payment Amount 7	10	This amount is identified by the amount indicator in position 25, Sector 1 of the Payer/Transmitter "A" Record.
102-111	Payment Amount 8	10	This amount is identified by the amount indicator in position 26, Sector 1 of the Payer/Transmitter "A" Record.
112-121	Payment Amount 9	10	This amount is identified by the amount indicator in position 27, Sector 1 of the Payer/Transmitter "A" Record.
122-180	Blank	59	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose Taxpayer Identification Number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
43-82	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
83-122	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.

RECORD NAME: PAYEE "B" RECORD (USING NINE PAYMENT FIELDS)-Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
123-180	BLANK	58	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be a "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-31	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
32-33	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
34-42	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
43-126	Blank	84	REQUIRED. Enter blanks.
127-128	State Code	2	REQUIRED. If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 14.10. For those states NOT participating in this program or for Form 1098 ENTER BLANKS.
129-180	Blank	52	REQUIRED. Enter blanks.

SEC. 6. PAYEE "B" RECORD—RECORD LAYOUTS FOR FORMS 1098, 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 1099-R AND 5498

PAYEE "B" RECORD—RECORD LAYOUT (USING ONE PAYMENT AMOUNT FIELD)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	BLANK
22—31	32—41	42—81	82—121	122—180

PAYEE "B" RECORD (USING ONE PAYMENT AMOUNT FIELDS)—Continued

Sector 2

RECORD SEQUENCE	RECORD TYPE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE
1	2	3—42	43—71	72—73	74—82

Sector 2 (Continued)

BLANK	STATE CODE	BLANK
83—126	127—128	129—180

PAYEE "B" RECORD—RECORD LAYOUT (USING TWO PAYMENT AMOUNT FIELDS)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—91	92—180

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE
1	2	3—42	43—82	83—111	112—113	114—122

Sector 2 (Continued)

BLANK	STATE CODE	BLANK
123—126	127—128	129—180

PAYEE "B" RECORD—RECORD LAYOUT (USING THREE PAYMENT AMOUNT FIELDS)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

PAYEE "B" RECORD—(USING THREE PAYMENT AMOUNT FIELDS)—Continued

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52-61	62—101	102—180

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE
1	2	3—42	43—82	83—111	112—113	114—122

Sector 2 (Continued)

BLANK	STATE CODE	BLANK
123—126	127—128	129—180

PAYEE "B" RECORD—RECORD LAYOUT (USING FOUR PAYMENT AMOUNT FIELDS)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—61	62—71	72—111	112—180

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE
1	2	3—42	43—82	83—111	112—113	114—122

Sector 2 (Continued)

BLANK	STATE CODE	BLANK
123—126	127—128	129—180

PAYEE "B" RECORD—RECORD LAYOUT (USING FIVE PAYMENT AMOUNT FIELDS)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	PAYMENT AMOUNT 5	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—61	62—71	72—81	82—121	122—180

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE
1	2	3—42	43—82	83—111	112—113	114—122

Sector 2 (Continued)

BLANK	STATE CODE	BLANK
123—126	127—128	129—180

PAYEE "B" RECORD—RECORD LAYOUT (USING SIX PAYMENT AMOUNT FIELDS)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3-4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	PAYMENT AMOUNT 5	PAYMENT AMOUNT 6
22—31	32—41	42—51	52—61	62—71	72—81	82—91

Sector 1 (Continued)

BLANK
92—180

PAYEE "B" RECORD—RECORD LAYOUT (USING SIX PAYMENT AMOUNT FIELDS)—Continued

Sector 2

RECORD SEQUENCE	RECORD TYPE	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	BLANK
1	2	3—42	43—82	83—122	123—180

Sector 3

RECORD SEQUENCE	RECORD TYPE	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK	STATE CODE	BLANK
1	2	3—31	32—33	34—42	43—126	127—128	129—180

PAYEE "B" RECORD—RECORD LAYOUT (USING SEVEN PAYMENT AMOUNT FIELDS)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	PAYMENT AMOUNT 5	PAYMENT AMOUNT 6
22—31	32—41	42—51	52—61	62—71	72—81	82—91

Sector 1 (Continued)

PAYMENT AMOUNT 7	BLANK
92—101	102—180

Sector 2

RECORD SEQUENCE	RECORD TYPE	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	BLANK
1	2	3—42	43—82	83—122	123—180

Sector 3

RECORD SEQUENCE	RECORD TYPE	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK	STATE CODE	BLANK
1	2	3—31	32—33	34—42	43—126	127—128	129—180

PAYEE "B" RECORD—RECORD LAYOUT (USING EIGHT PAYMENT AMOUNT FIELDS)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	PAYMENT AMOUNT 5	PAYMENT AMOUNT 6
22—31	32—41	42—51	52—61	62—71	72—81	82—91

Sector 1 (Continued)

PAYMENT AMOUNT 7	PAYMENT AMOUNT 8	BLANK
92—101	102—111	112—180

Sector 2

RECORD SEQUENCE	RECORD TYPE	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	BLANK
1	2	3—42	43—82	83—122	123—180

Sector 3

RECORD SEQUENCE	RECORD TYPE	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK	STATE CODE	BLANK
1	2	3—31	32—33	34—42	43—126	127—128	129—180

PAYEE "B" RECORD—RECORD LAYOUT (USING NINE PAYMENT AMOUNT FIELDS)

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	PAYMENT AMOUNT 5	PAYMENT AMOUNT 6
22—31	32—41	42—51	52—61	62—71	72—81	82—91

Sector 1 (Continued)

PAYMENT AMOUNT 7	PAYMENT AMOUNT 8	PAYMENT AMOUNT 9	BLANK
92—101	102—111	112—121	122—180

PAYEE "B" RECORD—RECORD LAYOUT (USING NINE PAYMENT AMOUNT FIELDS)—Continued

Sector 2

RECORD SEQUENCE	RECORD TYPE	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	BLANK
1	2	3—42	43—82	83—122	123—180

Sector 3

RECORD SEQUENCE	RECORD TYPE	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK	STATE CODE	BLANK
1	2	3—31	32—33	34—42	43—126	127—128	129—180

SEC. 7. PAYEE "B" RECORDS—FIELD DESCRIPTIONS FOR FORM 1099-A

.01 This section contains the general payment information from individual statements for Form 1099-A. For detailed explanations of the 1099-A fields request a copy of the 1985 "Instructions for Form 1099 Series, 1098, 5498 and 1096," available from local IRS offices.

.02 For Form 1099-A, SECTOR 3 will be required if there is more than one payment field to be reported in the Payee "B" Record.

.03 FORM 1099-A CANNOT BE FILED UNDER THE COMBINED FEDERAL/STATE FILING PROGRAM.

RECORD NAME: PAYEE "B" RECORD
FORM 1099-A

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1			
1	Record Sequence	1	REQUIRED. Must be a "1". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-4	Payment Year	2	REQUIRED. Must be the last two digits of the year for which payments are being reported (e.g., if payments were made in 1985 enter "85"). Must be incremented each year.
5	Document Specific Code	1	REQUIRED. For Form 1099-A enter blank.
6-7	Blank	2	REQUIRED. Enter blanks. (Reserved for IRS use). Mini-Disk position 6 is used to indicate a corrected return. Refer to Part A, Sec. 10 for specific instructions on how to file corrected returns utilizing either magnetic media or paper forms.
8-11	Name Control	4	REQUIRED. Enter the first 4 letters of the surname of the payee. Surnames of less than four (4) letters should be left justified, filling the unused positions with blanks. Special characters and imbedded blanks should be removed. IF THE NAME CONTROL IS NOT DETERMINABLE BY THE PAYER, LEAVE THIS FIELD BLANK. A dash (—) or ampersand (&) are the only acceptable special characters.
12	Type of TIN	1	REQUIRED. This field is used to identify the Taxpayer Identification Number (TIN) in positions 13-21 as either an Employer Identification Number, a Social Security Number, or the reason

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			no number is shown. Enter the appropriate code from the table below: *Type of TIN* / *TIN* / *Type of Account* 1 / EIN / A business or an organization 2 / SSN / An individual 9 / SSN / The payee is a foreign individual and not a U.S. resident blank / N/A / A Taxpayer Identification Number is required but unobtainable due to legitimate cause; e.g. number applied for but not received.
13-21	Taxpayer Identification Number	9	REQUIRED. Enter the valid 9-digit Taxpayer Identification Number of the payee (SSN or EIN, as appropriate). Where an identification number has been applied for but not received or where there is any other legitimate cause for not having an identification number, *enter blanks*. *DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROS*. Any record containing an invalid identification number in this field will be returned for correction.
22-31	Payer's Account Number for Payee	10	REQUIRED. Payer may use this field to enter the payee's account number. The use of this item will facilitate easy reference to specific records in the payer's file should any questions arise. DO NOT ENTER A TAXPAYER IDENTIFICATION NUMBER IN THIS FIELD. Enter blanks if the Payer's Account Number for Payee is not to be entered in this field. An account number can be any account number assigned by the payer to the payee (i.e., checking account, savings account, etc.). THIS NUMBER WILL HELP TO DISTINGUISH THE INDIVIDUAL PAYEE'S ACCOUNT WITH YOU AND THE SPECIFIC TRANSACTION MADE WITH THE ORGANIZATION SHOULD MULTIPLE RETURNS BE FILED. This information will be particularly necessary if you need to file a corrected return. You are strongly encouraged to use this field. You may use any number that will help identify the particular transaction that you are reporting.
	Payment Amount Fields		The number of payment amounts is dependent upon and must agree with the number of Amount Indicators present in positions 19-27 of Sector 1 of the "A" Record. The First Payee Name Line *must* appear immediately after the last payment amount indicated as being used. For example, if you are reporting 1099-INT and you used only Amount Indicator "3" in the Payer/Transmitter "A" Record, then you will only use one ten position payment amount in the Payee "B" Record, right justified, and the First Payee Name Line will begin in position 42. Each payment field that you allow for, or use, must contain 10 numeric characters (see following NOTE). Do not provide a payment amount field when the corresponding Amount Indicator in the Payer/Transmitter "A" Record is blank. Each payment amount must be entered in dollars and cents. Do not enter dollar sign

RECORD NAME: PAYEE "B" RECORD—Continued
FORM 1099-A

Min-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			commas, decimal points, or *NEGATIVE PAYMENTS* (except those items that reflect a loss on Form 1099-B and must be negative overpunched in the units position). Example: If the Amount Indicators are reflected as "123bbbbbb", the Payee "B" Records must have only 3 payment amount fields. If Amount Indicators are reflected as "12367bbbb", the "B" Records must have only 5 payment amount fields. Payment amounts MUST be right-justified and unused portions MUST be zero-filled. NOTE 1: If any one payment amount exceeds "9999999999" (dollars and cents), as many SEPARATE Payee "B" Records as necessary to contain the total amount MUST be submitted for the Payee. NOTE 2: If you file 1099-MISC and use Amount Code "8" in the Amount Indicator field of the Payer/Transmitter "A" Record, you must enter 0000000100 in the corresponding Payment Amount Field. This will not represent an actual money amount; this is an amount *code*. (Refer to PART B, Sec. 4, NOTE 1, of the Amount Indicators, Form 1099-MISC, for clarification.)
32-41	Payment Amount 1	10	REQUIRED. This amount is identified by the indicator in position 19, Sector 1, of the Payer/Transmitter "A" Record. *This amount must always be present.*

Determine at this point the number of payment fields to be reported within the Payee "B" Record. This can be determined from the number of Amount Indicators appearing in positions 19-27 of Sector 2 of the Payer/Transmitter "A" Record. Following are the formats for completing positions 42-180 of SECTOR 1, positions 1-180 of SECTOR 2 and positions 1-180 of SECTOR 3 of the Payee "B" Record. *FOR FORM 1099-A SECTOR 3 WILL BE REQUIRED IF THERE IS MORE THAN ONE PAYMENT FIELD TO BE REPORTED IN THE PAYEE "B" RECORD.* Use the appropriate format as required.

RECORD NAME: PAYEE "B" RECORD (USING ONE PAYMENT FIELD)—Continued
FORM 1099-A

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-81	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear immediately after the last payment amount indicated as being *used*. Do not enter *address* information on this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 of SECTOR 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose Taxpayer Identification Number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
82-121	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple pay-

RECORD NAME: PAYEE "B" RECORD (USING ONE PAYMENT FIELD)—Continued
FORM 1099-A

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			ees, this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 above. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
122-180	Blank	59	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
43-71	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state the ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
72-73	Payee State	2	REQUIkED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
74-82	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
83-88	Lender's Date of Acquisition or Abandonment	6	REQUIRED *FOR FORM 1099-A only*. Enter the date of your acquisition of the secured property or the date you first knew or had reason to know that the property was abandoned in the format MMDDYY. DO NOT ENTER HYPHENS OR SLASHES.
89	Liability Indicator	1	REQUIRED *FOR FORM 1099-A only*. Enter the appropriate indicator from table below: *Indicator* — *Usage* 1 — Borrower is personally liable for repayment of the debt. Blank — Borrower is *not* liable for repayment of the debt.
90-126	Description	37	REQUIRED *FOR FORM 1099-A only*. Enter a brief description of the property. For example, for real property, enter the address, section, lot and block. For personal property, enter the

RECORD NAME: PAYEE "B" RECORD (USING ONE PAYMENT FIELD—Continued
FORM 1099-A

Disk on	Field Title	Length	Description and Remarks
TOR 2 (Continued)			
			type, make and model (e.g., Car-1985 Buick Regal or Office Equipment, etc.).
80	Blank	54	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)
FORM 1099-A

Disk ion	Field Title	Length	Description and Remarks
TOR 1 (Continued)			
1	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1, of the Payer/Transmitter "A" Record.
1	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 of Sector 1. If fewer than 40 character are required, left justify and fill unused positions with blanks. If more space is required, utilize the Second Payee Name Line below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
80	Blank	89	REQUIRED. Enter blanks.
TOR 2			
	Record Sequence	1	REQUIRED. Must be "2". Used to sequence the sectors making up a Service PAYEE Record.
	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
2	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than payee's mailing address.

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENTS FIELDS)—Continued
FORM 1099-A

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
123-180	Blank	58	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-82	Blank	80	REQUIRED. Enter blanks.
83-88	Lender's Date of Acquisition or Abandonment	6	REQUIRED FOR FORM 1099-A ONLY. Enter the date of your acquisition of the secured property or the date you first knew or had reason to know that the property was abandoned in the format MMDDYY. DO NOT ENTER HYPHENS OR SLASHES.
89	Liability Indicator	1	REQUIRED *FOR FORM 1099-A ONLY*. Enter the appropriate indicator from table below: *Indicator* — Usage 1 — Borrower is personally liable for repayment of the debt. Blank — Borrower is *not* liable for repayment of the debt.
90-126	Description	37	REQUIRED *FOR FORM 1099-A ONLY*. Enter a brief description of the property. For example, for real property, enter the address, section, lot and block. For personal property, enter the type, make and model (e.g., Car-1985 Buick Regal or Office Equipment, etc.).
127-180	Blank	54	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)
FORM 1099-A

ni-Disk sition	Field Title	Length	Description and Remarks
CTOR 1 (Continued)			
-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1 of the Payer/Transmitter "A" Record.
-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1 of the Payer/Transmitter "A" Record.
-101	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose Taxpayer Identification Number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
2-180	Blank	79	REQUIRED. Enter blanks.
CTOR 2			
	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
	Record Type	1	REQUIRED. Enter "B." Must be the second position of each PAYEE Record.
42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 of Sector 1. Do not enter address information in this field. Let justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
2-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)—Continued
FORM 1099-A

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
123-180	Blank	58	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-82	Blank	80	REQUIRED. Enter blanks.
83-88	Lender's Date of Acquisition or Abandoment	6	REQUIRD FOR FORM 1099-A ONLY. Enter the date of your acquisition of the secured property or the date you first knew or had reason to know that the property was abandoned in the format MMDDYY. DO NOT ENTER HYPHENS OR SLASHES.
89	Liability Indicator	1	REQUIRED *FOR FORM 1099-A ONLY*. Enter the appropriate indicator from the table below: *Indicator* — *Usage* 1 — Borrower is personally liable for repayment of the debt. Blank — Borrower is *not* liable for repayment of the debt.
90-126	Description	37	REQUIRED *FOR FORM 1099-A ONLY*. Enter a brief description of the property. For example, for real property, enter the address, section, lot and block. For personal property, enter the type, make and model (e.g., Car-1985 Buick Regal or Office Equipment, etc.)
127-180	Blank	54	REQUIRED. Enter blanks.

8. PAYEE "B" RECORD—RECORD LAYOUT FOR FORM 1099-A

PAYEE "B" RECORD—RECORD LAYOUT (USING ONE PAYMENT AMOUNT FIELD)
FORM 1099-A

or 1

RECORD EQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

or 1 (Continued)

PAYER'S CCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	BLANK
22—31	32—41	42—81	82—121	122—180

or 2

RECORD EQUENCE	RECORD TYPE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE
1	2	3—42	43—71	72—73	74—82

or 2 (Continued)

LENDER'S DATE OF ACQUISITION R ABANDONMENT	LIABILITY INDICATOR	DESCRIPTION	BLANK
83—88	89	90—126	127—180

PAYEE "B" RECORD—RECORD LAYOUT (USING TWO PAYMENT AMOUNT FIELDS)
FORM 1099-A

tor 1

RECORD EQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

tor 1 (Continued)

PAYER'S CCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	FIRST PAYMENT NAME LINE	BLANK
22—31	32—41	42—51	52—91	92—180

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)—Continued
FORM 1099-A

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE
1	2	3—42	43—82	83—111	112—113	114—122

Sector 2 (Continued)

BLANK
123—180

Sector 3

RECORD SEQUENCE	RECORD TYPE	BLANK	LENDER'S DATE OF ACQUISITION OR ABANDONMENT	LIABILITY INDICATOR	DESCRIPTION	BLANK
1	2	3—82	83—88	89	90—126	127—180

PAYEE "B" RECORD—RECORD LAYOUT (USING THREE PAYMENT AMOUNT FIELDS)
FORM 1099-A

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYER'S ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—61	62—101	102—180

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE
1	2	3—42	43—82	83—111	112—113	114—122

Sector 2 (Continued)

BLANK
123—180

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)—Continued
FORM 1099-A

tor 3

RECORD SEQUENCE	RECORD TYPE	BLANK	LENDER'S DATE OF ACQUISITION OR ABANDONMENT	LIABILITY INDICATOR	DESCRIPTION	BLANK
1	2	3—82	83—88	89	90—126	127—180

. 9. PAYEE "B" RECORDS—FIELD SCRIPTIONS FOR FORM 1099-B

01 This section contains the general ment information from individual ements for Form 1099-B. For de- ed explanations of the 1099-B fields request a copy of the 1985 "Instructions for Form 1099 Series, 1098, 5498, and 1096" available from local IRS offices.

.02 For Form 1099-B, SECTOR 3 will be required if there is more than one payment field to be reported in the Payee "B" Record.

.03 FORM 1099-B CANNOT BE FILED UNDER THE COMBINED FEDERAL/STATE FILING PROGRAM.

RECORD NAME: PAYEE "B" RECORD
FORM 1099-B

i-Disk tion	Field Title	Length	Description and Remarks
TOR 1			
	Record Sequence	1	REQUIRED. Must be a "1". Used to sequence the sectors making up a Service PAYEE Record.
	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
	Payment Year	2	REQUIRED. Must be the last two digits of the year for which payments are being reported (e.g. if payments were made in 1985 enter "85"). Must be incremented each year.
	Document Specific Code	1	REQUIRED. For Form 1099-B enter blank.
	Blank	2	REQUIRED. Enter blanks. (Reserved for IRS use.) Mini-Disk position 6 is used to indicate a corrected return. Refer to Part A, Sec. 10 for specific instructions on how to file corrected returns utilizing either magnetic media or paper forms.
	Name Control	4	REQUIRED. Enter the first 4 letters of the surname of the payee. Surnames of less than four (4) letters should be left justified, filling the unused positions with blanks. Special characters and imbedded blanks should be removed. IF THE NAME CONTROL IS NOT DETERMINABLE BY THE PAYER, LEAVE THIS FIELD BLANK. A dash (–) or ampersand (&) are the only acceptable special characters.
	Type of TIN	1	REQUIRED. This field is used to identify the Taxpayer Identification Number (TIN) in positions 13-21 as either an Employer Identification Number, a Social Security Number, or the reason

RECORD NAME: PAYEE "B" RECORD—Continued
FORM 1099-B

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			no number is shown. Enter the appropriate code from the table below:

Type of TIN	*TIN*	*Type of Account*
1	EIN	A business or an organization
2	SSN	An individual
9	SSN	The payee is a foreign individual and not a U.S. resident
blank	N/A	A Taxpayer Identification Number is required but unobtainable due to legitimate cause; e.g. number applied for but not received.

13-21	Taxpayer Identification Number	9	REQUIRED. Enter the valid 9-digit Taxpayer Identification Number of the payee (SSN or EIN, as appropriate). Where an identification number has been applied for but not received or where there is any other legitimate cause for not having an indentification number, *enter blanks*. *DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROS*. Any record containing an invalid identification number in this field will be returned for correction
22-31	Payer's Account Number for Payee	10	REQUIRED. Payer may use this field to enter the payee's account number. The use of this item will facilitate easy reference to specific records in the payer's file, should any questions arise. DO NOT ENTER A TAXPAYER IDENTIFICATION NUMBER IN THIS FIELD. Enter blanks if the Payer's Account Number for Payee is not to be entered in this field. An account number can be any account number assigned by the payer to the payee (i.e., checking account, savings account, etc.). THIS NUMBER WILL HELP TO DISTINGUISH THE INDIVIDUAL PAYEE'S ACCOUNT WITH YOU AND THE SPECIFIC TRANSACTION MADE WITH THE ORGANIZATION, SHOULD MULTIPLE RETURNS BE FILED. This information will be particularly necessary if you need to file a corrected return. You are strongly encouraged to use this field. You may use any number that will help identify the particular transaction that you are reporting.
	Payment Amount Fields		The number of payment amounts is dependent on the number of Amount Indicators present in positions 19-27 of Sector 1 of the "A" Record. The First Payee Name Line *must* appear immediately after the last payment amount indicated as being used. For example, if you are reporting 1099-INT and you used only Amount Indicator "3" in the Payer/Transmitter "A" Record, then you will only use one ten position payment amount in the Payee "B" Record, right justified, and the First Payee Name Line will begin in position 42. Each payment field that you allow for, or

RECORD NAME: PAYEE "B" RECORD—Continued
FORM 1099-B

-Disk ion	Field Title	Length	Description and Remarks
TOR 1 (Continued)			
			use, must contain 10 numeric characters (see following NOTE). Do not provide a payment amount field when the corresponding Amount Indicator in the Payer/Transmitter "A" Record is blank. Each payment amount must be entered in dollars and cents. Do not enter dollar signs, commas, decimal points, or *NEGATIVE PAYMENTS* (except those items that reflect a loss on Form 1099-B and must be negative overpunched in the units position). Example: If the Amount Indicators are reflected as "123bbbbbb", the Payee "B" Records must have only 3 payment amount fields. If Amount Indicators are reflected as "12367bbbb", the "B" Records must have only 5 payment amount fields. Payment amounts MUST be right-justified and unused portions MUST be zero-filled. NOTE: 1 If any one payment amount exceeds "9999999999" (dollars and cents), as many SEPARATE Payee "B" Records as necessary to contain the total amount MUST be submitted for the Payee. NOTE 2: If you file 1099-MISC and use Amount Code "8" in the Amount Indicator field of the Payer/Transmitter "A" Record, you must enter 0000000100 in the corresponding Payment Amount Field. This will not represent an actual money amount; this is an amount *code*. (Refer to PART B., Sec. 3, NOTE 1, of the Amount Indicators, Form 1099-MISC, for clarification.)
1	Payment Amount 1	10	REQUIRED. This amount is identified by the indicator in position 19 of Sector 1 of the Payer/Transmitter "A" Record. *This amount must always be present.*

Determine at this point the number of payment fields to be reported within the Payee "B" Record. This can be determined from the number of Amount Indicators appearing in positions 19-27 of Sector 1 of the Payer/Transmitter "A" Record. Following are the formats for completing positions 42-180 of SECTOR 1, positions 1-180 of SECTOR 2 and positions 1-180 of SECTOR 3 of the Payee "B" Record. *FOR FORM 1099-B SECTOR 3 WILL BE REQUIRED IF THERE IS MORE THAT ONE PAYMENT FIELD TO BE REPORTED IN THE PAYEE "B" RECORD.* Use the appropriate format as required.

RECORD NAME: PAYEE "B" RECORD (USING ONE PAYMENT FIELD
FORM 1099-B

i-Disk ition	Field Title	Length	Description and Remarks
CTOR 1 (Continued)			
81	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear immediately after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 above. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee

RECORD NAME PAYEE "B" RECORD (USING ONE PAYMENT FIELD)—Continued
FORM 1099-B

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			whose Taxpayer Identification Number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
82-121	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 of SECTOR 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
122-180	Blank	59	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B." Must be the second position of each PAYEE Record.
3-42	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
43-71	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
72-73	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
74-82	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
83-85	Blank	3	REQUIRED. Enter blanks.
86	Date of Sale Indicator	1	REQUIRED *FOR FORM 1099-B ONLY*. Enter appropriate indicator from table below: *Indicator* — *Usage* S — Date of Sale is the actual settlement date blank — Date of Sale is the trade date or this is an aggregate transaction

RECORD NAME: PAYEE "B" RECORD (USING ONE PAYMENT FIELD)—(Continued)
FORM 1099-B

Disk Pgm	Field Title	Length	Description and Remarks
OR 2 (Continued)			
	Date of Sale	6	REQUIRED *FOR FORM 1099-B ONLY*. Enter the trade date or the actual settlement date of the transaction in the format MMDDYY. Enter blanks if this is an aggregate transaction. DO NOT ENTER HYPHENS OR SLASHES.
	CUSIP No.	8	REQUIRED *FOR FORM 1099-B ONLY*. Enter the CUSIP (Committee on Uniform Security Identification Procedures) number of the items reported for Amount Indicator "2" (Stocks, bonds, etc.). Enter blanks if this is an aggregate transaction. Enter "0" (zeroes) if the number is not available. For CUSIP numbers with more than 8 characters, supply the *first* 8.
6	Description	26	REQUIRED *FOR FORM 1099-B ONLY*. Enter a brief description of the item or services for which the proceeds are being reported. If fewer than 26 characters are required, left justify and fill unused positions with blanks. For regulated futures contracts, enter the customer account number. Enter blanks if this is an aggregate transaction.
0	Blank	54	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)
FORM 1099-B

Disk Pgm	Field Title	Length	Description and Remarks
OR 1 (Continued)			
	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1, of the Payer/Transmitter "A" Record.
	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
	Blank	89	REQUIRED. Enter blanks.
OR 2			
	Record Sequence	1	REQUIRED. Must be "2". Used to sequence the sectors making up a Service PAYEE Record.

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)—Continued
FORM 1099-B

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
123-180	Blank	58	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-85	Blank	83	REQUIRED. Enter blanks.
86	Date of Sale Indicator	1	REQUIRED *FOR FORM 1099-B ONLY*. Enter appropriate indicator from table below: *Indicator* — *Usage* S — Date of Sale is the actual settlement date blank — Date of Sale is the trade date or this is an aggregate transaction
87-92	Date of Sale	6	REQUIRED *FOR FORM 1099-B ONLY*. Enter the trade date or

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)—Continued
FORM 1099-B

-Disk ion	Field Title	Length	Description and Remarks
TOR 3 (Continued)			
			the actual settlement date of the transaction in the format MMDDYY. Enter blanks if this is an aggregate transaction. DO NOT ENTER HYPHENS OR SLASHES.
0	CUSIP No.	8	REQUIRED *FOR FORM 1099-B ONLY*. Enter the CUSIP (Committee on Uniform Security Identification Procedures) number of the items reported for Amount Indicator "2" (Stocks, bonds, etc.). Enter blanks if this is an aggregate transaction. Enter "0" (zeroes) if the number is not available. For CUSIP numbers with more than 8 characters, supply the *first* 8.
26	Description	26	REQUIRED *FOR FORM 1099-B ONLY*. Enter a brief description of the item or services for which the proceeds are being reported. If fewer than 26 characters are required, left justify and fill unused positions with blanks. For regulated futures contracts, enter the customer account number. Enter blanks if this is an aggregate transaction.
80	Blank	54	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)
FORM 1099-B

-Disk ion	Field Title	Length	Description and Remarks
TOR 1 (Continued)			
	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1 of the Payer/Transmitter "A" Record.
	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1 of the Payer/Transmitter "A" Record.
01	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees. *only the name* of the payee whose Taxpayer Identification Number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
180	Blank	79	REQUIRED. Enter blanks.
TOR 2			
	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)—Continued
FORM 1099-B

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each payee record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name only in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
123-180	Blank	58	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-85	Blank	83	REQUIRED. Enter blanks.
86	Date of Sale Indicator	1	REQUIRED *FOR FORM 1099-B ONLY*. Enter appropriate indicator from table below: *Indicator* — *Usage* S — Date of Sale is the actual settlement date blank — Date of Sale is the trade date or this is an aggregate transaction

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)—Continued
FORM 1099-B

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
87-92	Date of Sale	6	*REQUIRED FOR FORM 1099-B ONLY.* Enter the trade date or the actual settlement date of the transaction in the format MMDDYY. Enter blanks if this is an aggregate transaction. DO NOT ENTER HYPHENS OR SLASHES.
93-100	CUSIP No.	8	REQUIRED *FOR FORM 1099-B ONLY.* Enter the CUSIP (Committee on Uniform Security Identification Procedures) number of the items reported for Amount Indicator "2" (Stocks, bonds, etc.). Enter blanks if this is an aggregate transaction. Enter "0" (zeroes) if the number is not available. For CUSIP numbers with more than 8 characters, supply the *first* 8.
101-126	Description	26	REQUIRED *FOR FORM 1099-B ONLY.* Enter a brief description of the item or services for which the proceeds are being reported. If fewer than 26 characters are required, left justify and fill unused positions with blanks. For regulated futures contracts, enter the customer account number. Enter blanks if this is an aggregate transaction.
127-180	Blank	54	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING FOUR PAYMENT FIELDS)
FORM 1099-B

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1, of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1, of the Payer/Transmitter "A" Record.
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position 22, Sector 1, of the Payer/Transmitter "A" Record.
72-111	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used.* Do not enter *address* information in this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name,* utilize the Second Payee Name Line below. If there are multiple payees, *only the name* of the payee whose taxpayer identification number has been provided should be entered in this field. The name of the other payees should be entered in the Second Payee Name Line field.
112-180	Blank	69	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING FOUR PAYMENT FIELDS)—Continued
FORM 1099-B

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be"2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
123-180	Blank	58	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-85	Blank	83	REQUIRED. Enter blanks.
86	Date of Sale Indicator	1	REQUIRED *FOR FORM 1099-B ONLY*. Enter appropriate indicator from table below: *Indicator* — *Usage* S — Date of Sale is the actual settlement

RECORD NAME: PAYEE "B" RECORD (USING FOUR PAYMENT FIELDS)—Continued
FORM 1099-B

ni-Disk sition	Field Title	Length	Description and Remarks
CTOR 3 (Continued)			
			blank — date Date of Sale is the trade date or this is an aggregate transaction
-92	Date of Sale	6	REQUIRED *FOR FORM 1099-B ONLY*. Enter the trade date or the actual settlement date of the transaction in the format MMDDYY. Enter blanks if this is an aggregate transaction. DO NOT ENTER HYPHENS OR SLASHES.
-100	CUSIP No.	8	REQUIRED *FOR FORM 1099-B ONLY*. Enter the CUSIP (Committee on Uniform Security Identification Procedures) number of the items reported for Amount Indicator "2" (Stocks, bonds, etc.). Enter blanks if this is an aggregate transaction. Enter "0" (zeroes) if the number is not available. For CUSIP numbers with more than 8 characters, supply the *first* 8.
1-126	Description	26	REQUIRED *FOR FORM 1099-B ONLY*. Enter a brief description of the item or services for which the proceeds are being reported. If fewer than 26 characters are required, left justify and fill unused positions with blanks. For regulated futures contracts, enter the customer account number. Enter blanks if this is an aggregate transaction.
7-180	Blank	54	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING FIVE PAYMENT FIELDS)
FORM 1099-B

lini-Disk osition	Field Title	Length	Description and Remarks
ECTOR 1 (Continued)			
2-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1, of the Payer/Transmitter "A" Record.
2-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1, of the Payer/Transmitter "A" Record.
2-71	Payment Amount 4	10	This amount is identified by the amount indicator in position 22, Sector 1, of the Payer/Transmitter "A" Record.
2-81	Payment Amount 5	10	This amount is identified by the amount indicator in position 23, Sector 1, of the Payer/Transmitter "A" Record.
2-121	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line below. If there are multiple payees, *only the name* of the payee whose

RECORD NAME: PAYEE "B" RECORD (USING FIVE PAYMENT FIELDS)—CONTINUED
FORM 1099-B

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			taxpayer identification number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
122-180	Blank	59	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be ued for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
123-180	Blank	58	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-85	Blank	83	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING FIVE PAYMENT FIELDS)—CONTINUED
FORM 1099-B

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
86	Date of Sale Indicator	1	REQUIRED *FOR FORM 1099-B ONLY*. Enter appropriate indicator from table below: *Indicator* — *Usage* S — Date of Sale is the actual settlement date blank — Date of Sale is the trade date or this is an aggregate transaction
87-92	Date of Sale	6	REQUIRED *FOR FORM 1099-B ONLY*. Enter the trade date or the actual settlement date of the transaction in the format MMDDYY. Enter blanks if this is an aggregate transaction. DO NOT ENTER HYPHENS OR SLASHES.
93-100	CUSIP No.	8	REQUIRED *FOR FORM 1099-B ONLY*. Enter the CUSIP (Committee on Uniform Security Identification Procedures) number of the items reported for Amount Indicator "2" (Stocks, bonds, etc.). Enter blanks if this is an aggregate transaction. Enter "0" (zeroes) if the number is not available. For CUSIP numbers with more than 8 characters, supply the *first* 8.
101-126	Description	26	REQUIRED *FOR FORM 1099-B ONLY*. Enter a brief description of the item or services for which the proceeds are being reported. If fewer than 26 characters are required, left justify and fill unused positions with blanks. For regulated futures contracts, enter the customer account number. Enter blanks if this is an aggregate transaction.
127-180	Blank	54	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING SIX PAYMENT FIELDS)
FORM 1099-B

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1 of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1 of the Payer/Transmitter "A" Record.
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position 22, Sector 1 of the Payer/Transmitter "A" Record.
72-81	Payment Amount 5	10	This amount is identified by the amount indicator in position 23, Sector 1 of the Payer/Transmitter "A" Record.
82-91	Payment Amount 6	10	This amount is identified by the amount indicator in position 24, Sector 1 of the Payer/Transmitter "A" Record.

RECORD NAME: PAYEE "B" RECORD (USING SIX PAYMENT FIELDS)—CONTINUED
FORM 1099-B

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
92-180	Blank	89	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter address information in this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose Taxpayer Identification Number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
43-82	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
83-122	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
123-180	Blank	58	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be a "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-31	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
32-33	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST*

RECORD NAME: PAYEE "B" RECORD (USING SIX PAYMENT FIELDS)—Continued
FORM 1099-B

ni-Disk ition	Field Title	Length	Description and Remarks
TOR 3 (Continued)			
			use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
42	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
85	Blank	43	REQUIRED. Enter blanks.
	Date of Sale Indicator	1	REQUIRED *FOR FORM 1099-B ONLY*. Enter appropriate indicator from table below: *Indicator* — *Usage* S — Date of Sale is the actual settlement date blank — Date of Sale is the trade date or this is an aggregate transaction
92	Date of Sale	6	REQUIRED *FOR FORM 1099-B ONLY*. Enter the trade date or the actual settlement date of the transaction in the format MMDDYY. Enter blanks if this is an aggregate transaction. DO NOT ENTER HYPHENS OR SLASHES.
100	CUSIP No.	8	REQUIRED *FOR FORM 1099-B ONLY*. Enter the CUSIP (Committee on Uniform Security Identification Procedures) number of the items reported for Amount Indicator "2" (Stocks, bonds, etc.). Enter blanks if this is an aggregate transaction. Enter "0" (zeroes) if the number is not available. For CUSIP numbers with more than 8 characters, supply the *first* 8.
-126	Description	26	REQUIRED FOR FORM 1099-B ONLY. Enter a brief description of the item or services for which the proceeds are being reported. If fewer than 26 characters are required, left justify and fill unused positions with blanks. For regulated futures contracts, enter the customer account number. Enter blanks if this is an aggregate transaction.
-180	Blank	54	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING SEVEN PAYMENT FIELDS)
FORM 1099-B

i-Disk tion	Field Title	Length	Description and Remarks
TOR 1 (Continued)			
51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1 of the Payer/Transmitter "A" Record.
61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1 of the Payer/Transmitter "A" Record.

RECORD NAME: PAYEE "B" RECORD (USING SEVEN PAYMENT FIELDS)—Continued
FORM 1099-B

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
62-71	Payment Amount 4	10	This amount is identified by the amount indicator in position 22, Section 1 of the Payer/Transmitter "A" Record.
72-81	Payment Amount 5	10	This amount is identified by the amount indicator in position 23, Sector 1 of the Payer/Transmitter "A" Record.
82-91	Payment Amount o	10	This amount is identified by the amount indicator in position 24, Sector 1 of the Payer/Transmitter "A" Record.
92-101	Payment Amount 7	10	This amount is identified by the amount indicator in position 25, Sector 1 of the Payer/Transmitter "A" Record.
102-180	Blank	79	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	First payee Name Line	40	REQUIRED. The First Payee Name line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose Taxpayer Identification Number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
43-82	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
83-122	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
123-180	Blank	58	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be a "3". Used to sequence the sectors mak-

RECORD NAME: PAYEE "B" RECORD (USING SEVEN PAYMENT FIELDS)—Continued
FORM 1099-B

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
			ing up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-31	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
32-33	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
34-42	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
43-85	Blank	43	REQUIRED. Enter blanks.
86	Date of Sale Indicator	1	REQUIRED *FOR FORM 1099-B ONLY*. Enter appropriate indicator from table below: *Indicator* — *Usage* S — Date of Sale is the actual settlement date blank — Date of Sale is the trade date or this is an aggregate transaction
87-92	Date of Sale	6	REQUIRED *FOR FORM 1099-B ONLY*. Enter the trade date or the actual settlement date of the transaction in the format MMDDYY. Enter blanks if this is an aggregate transaction. DO NOT ENTER HYPHENS OR SLASHES.
93-100	CUSIP No.	8	REQUIRED *FOR FORM 1099-B ONLY*. Enter the CUSIP (Committee on Uniform Security Identification Procedures) number of the items reported for Amount Indicator "2" (Stocks, bonds, etc.). Enter blanks if this is an aggregate transaction. Enter "0" (zeroes) if the number is not available. For CUSIP numbers with more than 8 characters, supply the *first* 8.
101-126	Description	26	REQUIRED *FOR FORM 1099-B ONLY*. Enter a brief description of the item or services for which the proceeds are being reported. If fewer than 26 characters are required, left justify and fill unused positions with blanks. For regulated futures contracts, enter the customer account number. Enter blanks if this is an aggregate transaction.
127-180	Blank	54	REQUIRED. Enter blanks.

SEC. 10. PAYEE "B" RECORD—RECORD LAYOUT FOR FORM 1099-B

PAYEE "B" RECORD—RECORD LAYOUT (USING ONE PAYMENT AMOUNT FIELD)
FORM 1099-B

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYERS' ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	BLANK
22—31	32—41	42—81	82—121	122—180

Sector 2

RECORD SEQUENCE	RECORD TYPE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK
1	2	3—42	43—71	72—73	74—82	83—85

Sector 2 (Continued)

DATE OF SALE INDICATOR	DATE OF SALE	CUSIP NO.	DESCRIPTION	BLANK
86	87—92	93—100	101—126	127—180

PAYEE "B" RECORD—RECORD LAYOUT (USING TWO PAYMENT AMOUNT FIELDS)
FORM 1099-B

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYERS' ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—41	52—91	92—180

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE
1	2	3—42	43—82	83—111	112—113	114—122

PAYEE "B" RECORD—RECORD LAYOUT (USING TWO PAYMENT AMOUNT FIELDS)—Continued
FORM 1099-B

ector 2 (Continued)

BLANK
123—180

ector 3

RECORD SEQUENCE	RECORD TYPE	BLANK	DATE OF SALE INDICATOR	DATE OF SALE	CUSIP NO.	DESCRIPTION	BLANK
1	2	3—85	86	87—92	93—100	101—126	127—180

PAYEE "B" RECORD—RECORD LAYOUT (USING THREE PAYMENT AMOUNT FIELDS)
FORM 1099-B

ector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYERS' ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—61	62—101	102—180

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE
1	2	3—42	43—82	83—111	112—113	114—122

Sector 2 (Continued)

BLANK
123—180

Sector 3

RECORD SEQUENCE	RECORD TYPE	BLANK	DATE OF SALE INDICATOR	DATE OF SALE	CUSIP NO.	DESCRIPTION	BLANK
1	2	3—85	86	87—92	93—100	101—126	127—180

PAYEE "B" RECORD—RECORD LAYOUT (USING FOUR PAYMENT AMOUNT FIELDS)
FORM 1099-B

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYERS' ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—61	62—71	72—111	112—180

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE
1	2	3—42	43—82	83—111	112—113	114—122

Sector 2 (Continued)

BLANK
123—180

Sector 3

RECORD SEQUENCE	RECORD TYPE	BLANK	DATE OF SALE INDICATOR	DATE OF SALE	CUSIP NO.	DESCRIPTION	BLANK
1	2	3—85	86	87—92	93—100	101—126	127—180

PAYEE "B" RECORD—RECORD LAYOUT (USING FIVE PAYMENT AMOUNT FIELDS)
FORM 1099-B

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYERS' ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	PAYMENT AMOUNT 5	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—61	62—71	72—81	82—121	122—180

PAYEE "B" RECORD—RECORD LAYOUT (USING FIVE PAYMENT AMOUNT FIELDS)—Continued
FORM 1099-B

ctor 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE
1	2	3—42	43—82	83—111	112—113	114—122

ctor 2 (Continued)

BLANK
123—180

ctor 3

RECORD EQUENCE	RECORD TYPE	BLANK	DATE OF SALE INDICATOR	DATE OF SALE	CUSIP NO.	DESCRIPTION	BLANK
1	2	3—85	86	87—92	93—100	101—126	127—180

PAYEE "B" RECORD—RECORD LAYOUT (USING SIX PAYMENT AMOUNT FIELDS)
FORM 1099-B

ctor 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

ctor 1 (Continued)

PAYERS' CCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	PAYMENT AMOUNT 5	PAYMENT AMOUNT 6
22—31	32—41	42—51	52—61	62—71	72—81	82—91

ctor 1 (Continued)

BLANK
92—180

ctor 2

RECORD SEQUENCE	RECORD TYPE	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	BLANK
1	2	3-42	43—82	83—122	123—180

PAYEE "B" RECORD—RECORD LAYOUT (USING SIX PAYMENT AMOUNT FIELDS)—Continued
FORM 1099-B

Sector 3

SEQUENCE RECORD	RECORD TYPE	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK
1	2	3—31	32—33	34—42	43—85

Sector 3 (Continued)

DATE OF SALE INDICATOR	DATE OF SALE	CUSIP NO.	DESCRIPTION	BLANK
86	87—92	93—100	100—126	127—180

PAYEE "B" RECORD—RECORD LAYOUT (USING SEVEN PAYMENT AMOUNT FIELDS)
FORM 1099-B

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYERS' ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	PAYMENT AMOUNT 4	PAYMENT AMOUNT 5	PAYMENT AMOUNT 6
22—31	32—41	42—51	52—61	62—71	72—81	82—91

Sector 1 (Continued)

PAYMENT AMOUNT 7	BLANK
92—101	102—180

Sector 2

RECORD SEQUENCE	RECORD TYPE	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	BLANK
1	2	3—42	43—82	83—122	123—180

Sector 3

RECORD SEQUENCE	RECORD TYPE	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK
1	2	3—31	32—33	34—42	43—85

PAYEE "B" RECORD—RECORD LAYOUT (USING SEVEN PAYMENT AMOUNT FIELDS)—Continued
FORM 1099-B

Sector 3 (Continued)

DATE OF SALE INDICATOR	DATE OF SALE	CUSIP NO.	DESCRIPTION	BLANK
86	87—92	93—100	101—126	127—180

SEC. 11. PAYEE "B" RECORDS—FIELD DESCRIPTIONS FOR FORM W-2G

.01 This section contains the general payment information from individual statements for Form W-2G. for detailed explanations of the W-2G fields, see W-3G, Transmittal of Certain Information Returns, which is available at local IRS offices.

.02 When reporting information for form W-2G, the Payee "B" Records must contain 3 sectors.

.03 FORM W-2G CANNOT BE FILED UNDER THE COMBINED FEDERAL/STATE FILING PROGRAM.

RECORD NAME: PAYEE "B" RECORD
FORM W-2G

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1			
1	Record Sequence	1	REQUIRED. Must be a "1". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-4	Payment Year	2	REQUIRED. Must be the last two digits of the year for which payments are being reported (e.g. if payments were made in 1985 enter "85"). Must be incremented each year.
5	Document Specific Code Type of Wager (Form W-2G only)	1	REQUIRED for W-2G. Use only for reporting the Type of Wager on *Form W-2G*. *Category* — *Code* Horse Race Track (or Off Track Betting of a Horse Track nature) — 1 Dog Race Track (or Off Track Betting of a Dog Track nature) — 2 Jai-alai — 3 State Conducted Lottery — 4 Keno — 5 Casino Type Bingo. DO NOT use this code for any other type of Bingo winnings (i.e. Church, Fire Dept. etc.). — 6 Slot Machines — 7 Any other types of gambling winnings. This includes Church Bingo, Fire Dept. Bingo, unlabeled winnings, etc. — 8
6-7	Blank	2	REQUIRED. Enter blanks. (Reserved for IRS use). Mini-Disk position 6 is used to indicate a corrected return. Refer to Part A, Sec. 10 for specific instructions on how to file corrected returns utilizing either magnetic media or paper forms.

RECORD NAME: PAYEE "B" RECORD—Continued
FORM W-2G

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
8-11	Name Control	4	REQUIRED. Enter the first 4 letters of the surname of the payee. Surnames of less than four (4) letters should be left justified, filling the unused positions with blanks. Special characters and imbedded blanks should be removed. IF THE NAME CONTROL IS NOT DETERMINABLE BY THE PAYER, LEAVE THIS FIELD BLANK. A dash (–) or ampersand (&) are the only acceptable special characters.
12	Type of TIN	1	REQUIRED. This field is used to identify the Taxpayer Identification Number (TIN) in positions 13-21 as either an Employer Identification Number, a Social Security Number, or the reason no number is shown. Enter the appropriate code from the table below: *Type of TIN* — *TIN* — *Type of Account* 1 — EIN — A business or an organization 2 — SSN — An individual 9 — SSN — The payee is a foreign individual and not a U.S. resident. blank — N/A — A Taxpayer Identification Number is required but unobtainable due to legitimate cause; e.g. number applied for but not received.
13-21	Taxpayer Identification Number	9	REQUIRED. Enter the valid 9-digit Taxpayer Identification Number of the payee (SSN or EIN, as appropriate). When an identification number has been applied for but not received or when there is any other legitimate cause for not having an identification number, *enter blanks.* *DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROS.*
22-31	Payer's Account Number for Payee	10	REQUIRED. Payer may use this field to enter the payee's account number. The use of this item will facilitate easy reference to specific records in the payer's file should any questions arise. DO NOT ENTER A TAXPAYER IDENTIFICATION NUMBER IN THIS FIELD. Enter blanks if the Payer's Account Number for Payee is not to be entered in this field. An account number can be any account number assigned by the payer to the payee (i.e., checking account, savings account, etc.). THIS NUMBER WILL HELP TO DISTINGUISH THE INDIVIDUAL PAYEE'S ACCOUNT WITH YOU AND THE SPECIFIC TRANSACTION MADE WITH THE ORGANIZATION, SHOULD MULTIPLE RETURNS BE FILED. This information will be particularly necessary if you need to file a corrected return. You are strongly encouraged to use this field. You may use any number that will help identify the particular transaction that you are reporting.
	Payment Amount Fields		The number of payment amounts is dependent on the number of Amount Indicators present in positions 19-27 of Sector 1 of the "A" Record. The First Payee Name Line *must* appear immediately after the last payment amount indicated as being used. For example, if you are reporting 1099-INT and you used only Amount Indicator

RECORD NAME: PAYEE "B" RECORD—Continued
FORM W-2G

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			"3" in the Payer/Transmitter "A" Record, then you will only use one ten position payment amount in the Payee "B" Record, right justified, and the First Payee Name Line will begin in position 42. Each payment field that you allow for, or use, must contain 10 numeric characters (see following NOTE). Do not provide a payment amount field when the corresponding Amount Indicator in the Payer/Transmitter "A" Record is blank. Each payment amount must be entered in dollars and cents. Do not enter dollar signs, commas, decimal points, or *NEGATIVE PAYMENTS* (except those items that reflect a loss on Form 1099-B and must be negative overpunched in the units position). Example: If the Amount Indicators are reflected as "123bbbbbb", the Payee "B" Records must have only 3 payment amount fields. If Amount Indicators are reflected as "12367bbbb", the "B" Records must have only 5 payment amount fields. Payment amounts MUST be right-justified and unused portions MUST be zero-filled. NOTE 1: If any one payment amount exceeds "9999999999" (dollars and cents), as many SEPARATE Payee "B" Records as necessary to contain the total amount MUST be submitted for the Payee. NOTE 2: If you file 1099-MISC and use Amount Code "8" in the Amount Indicator field of the Payer/Transmitter "A" Record, you must enter 0000000100 in the corresponding Payment Amount Field. This will not represent an actual money amount; this is an amount *code*. Refer to Part B., Sec. 2, NOTE 1, of the Amount Indicators, Form 1099-MISC, for clarification.)
32-41	Payment Amount 1	10	REQUIRED. This amount is identified by the indicator in position 19 of Sector 1 of the Payer/Transmitter "A" Record. *This amount must always be present.*
	Determine at this point the number of payment fields to be reported within the Payee "B" Record. This can be determined from the number of Amount Indicators appearing in positions 19-27 of Sector 1 of the Payer/Transmitter "A" Record. Following are the formats for completing positions 42-180 of SECTOR 1, positions 1-180 of SECTOR 2 and positions 1-180 of SECTOR 3 of the Payee "B" Record. *WHEN REPORTING INFORMATION FOR FORM W-2G THREE SECTORS MUST BE USED TO MAKE UP A PAYEE "B" RECORD.* Use the appropriate format as required.		
42-81	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear immediately after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 above. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, only the name of the payee whose Taxpayer Identification Number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
82-121	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 above. Do

RECORD NAME: PAYEE "B" RECORD (USING ONE PAYMENT FIELD—Continued
FORM W-2G

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
			not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
122-180	Blank	59	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
43-71	Payee City	29	REQUIRED. Enter the city, left justify and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
72-73	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
74-82	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
83-180	Blank	98	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be a "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-60	Blank	58	REQUIRED. Enter blanks.
61-66	Date Won	6	REQUIRED *FOR FORM W-2G ONLY*. Enter the date of the winning event in MMDDYY format. This is not the date the money was paid, if paid after the date of the race (or game). DO NOT ENTER HYPHENS OR SLASHES.
67-81	Transaction	15	REQUIRED *FOR FORM W-2G ONLY*. The ticket number, card

RECORD NAME: PAYEE "B" RECORD (USING ONE PAYMENT FIELD—Continued
FORM W-2G

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
			number (and color, if applicable), machine serial number or any other information that will help identify the winning transaction.
82-86	Race	5	REQUIRED *FOR FORM W-2G ONLY*. The race (or game) applicable to the winning ticket.
87-91	Cashier	5	REQUIRED *FOR FORM W-2G ONLY*. The initials of the cashier and/or the window number making the winning payment.
92-96	Window	5	REQUIRED *FOR FORM W-2G ONLY*. The location of the person paying the winnings.
97-111	First ID	15	REQUIRED *FOR FORM W-2G ONLY*. The first identification number of the person receiving the winnings.
112-126	Second ID	15	REQUIRED *FOR FORM W-2G ONLY*. The second identification number of the person receiving the winnings.
127-180	Blank	54	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)
FORM W-2G

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified as the amount indicator in position 20, Sector 1, of the Payer/Transmitter "A" Record.
52-91	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose Taxpayer Identification Number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line below. If there are multiple payees, *only the name* of the payee whose tTaxpayer Identification Number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
92-180	Blank	89	REQUIRED. Enter blanks.
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)—Continued
FORM W-2G

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2 (Continued)			
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees, this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
123-180	Blank	58	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)—Continued
FORM W-2G

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-60	Blank	58	REQUIRED. Enter blanks.
61-66	Date Won	6	REQUIRED *FOR FORM W-2G ONLY*. Enter the date of the winning event in MMDDYY format. This is not the date the money was paid, if paid after the date of the race (or game). DO NOT ENTER HYPHENS OR SLASHES.
67-81	Transaction	15	REQUIRED *FOR FORM W-2G ONLY*. The ticket number, card

RECORD NAME: PAYEE "B" RECORD (USING TWO PAYMENT FIELDS)—Continued
FORM W-2G

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
			number (and color, if applicable), machine serial number or any other information that will help identify the winning transaction.
82-86	Race	5	REQUIRED *FOR FORM W-2G ONLY*. The race (or game) applicable to the winning ticket.
87-91	Cashier	5	REQUIRED *FOR FORM W-2G ONLY*. The initials of the cashier and/or the window number making the winning payment.
92-96	Window	5	REQUIRED *FOR FORM W-2G ONLY*. The location of the person paying the winnings.
97-111	First ID	15	REQUIRED *FOR FORM W-2G ONLY*. The first identification number of the person receiving the winnings.
112-126	Second ID	15	REQUIRED *FOR FORM W-2G ONLY*. The second identification number of the person receiving the winnings.
127-180	Blank	54	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)
FORM W-2G

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 1 (Continued)			
42-51	Payment Amount 2	10	This amount is identified by the amount indicator in position 20, Sector 1 of the Payer/Transmitter "A" Record.
52-61	Payment Amount 3	10	This amount is identified by the amount indicator in position 21, Sector 1 of the Payer/Transmitter "A" Record.
62-101	First Payee Name Line	40	REQUIRED. The First Payee Name Line must appear after the last payment amount indicated as being *used*. Do not enter *address* information in this field. Enter the name of the payee whose taxpayer identification number appears in positions 13-21 of Sector 1. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required *for the name*, utilize the Second Payee Name Line field below. If there are multiple payees, *only the name* of the payee whose tTaxpayer Identification Number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field.
102-180	Blank	79	REQUIRED. Enter blanks.

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)—Continued
FORM W-2G

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 2			
1	Record Sequence	1	REQUIRED. Must be a "2". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-42	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name *only* in this field. If there are multiple payees' this field may be used for those payees' *names* who are not associated with the Taxpayer Identification Number in positions 13-21 of Sector 1. Do not enter address information in this field. Left justify and fill unused positions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE PRESENT FOR THIS FIELD.
43-82	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. Address MUST be present. This field MUST NOT contain any data other than the payee's mailing address.
83-111	Payee City	29	REQUIRED. Enter the city, left justified and fill the unused positions with blanks. Do *not* enter state and ZIP Code information in this field. (If the payee lives outside of the United States, include their current mailing address and spell out the name of the country if possible.)
112-113	Payee State	2	REQUIRED. Enter the abbreviation for the state. You *MUST* use valid U.S. Postal Service abbreviations for states as shown in the table in Part A, Sec. 16. Use this field for state information *only*.
114-122	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left justify and fill the unused positions with blanks. Use this field for the ZIP Code *only*.
123-180	Blank	58	REQUIRED. Enter blanks.
SECTOR 3			
1	Record Sequence	1	REQUIRED. Must be "3". Used to sequence the sectors making up a Service PAYEE Record.
2	Record Type	1	REQUIRED. Enter "B". Must be the second position of each PAYEE Record.
3-60	Blank	58	REQUIRED. Enter blanks.
61-66	Date Won	6	REQUIRED *FOR FORM W-2G ONLY*. Enter the date of the winning event in MMDDYY format. This is not the date the money was paid, if paid after the date of the race (or game). DO NOT ENTER HYPHENS OR SLASHES.
67-81	Transaction	15	REQUIRED *FOR FORM W-2G ONLY*. The ticket number, card

RECORD NAME: PAYEE "B" RECORD (USING THREE PAYMENT FIELDS)—Continued
FORM W-2G

Mini-Disk Position	Field Title	Length	Description and Remarks
SECTOR 3 (Continued)			
	TRANSACTION (Continued)		number (and color, if applicable), machine serial number or any other information that will help identify the winning transaction.
82-86	Race	5	REQUIRED *FOR FORM W-2G ONLY*. The race (or game) applicable to the winning ticket.
87-91	Cashier	5	REQUIRED *FOR FORM W-2G ONLY*. The initials of the cashier and/or the window number making the winning payment.
92-96	Window	5	REQUIRED *FOR FORM W-2G ONLY*. The location of the person paying the winnings.
97-111	First ID	15	REQUIRED *FOR FORM W-2G ONLY*. The first identification number of the person receiving the winnings.
112-126	Second ID	15	REQUIRED *FOR FORM W-2G ONLY*. The second identification number of the person receiving the winnings.
127-180	Blank	54	REQUIRED. Enter blanks.

SEC. 12. PAYEE "B" RECORD—RECORD LAYOUTS FOR FORM W-2G

PAYEE "B" RECORD—RECORD LAYOUT (USING ONE PAYMENT AMOUNT FIELD)
Form W-2G

SECTOR 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYERS' ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE	BLANK
22—31	32—41	42—81	82—121	122—180

Sector 2

RECORD SEQUENCE	RECORD TYPE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK
1	2	3—42	43—71	72—73	74—82	83—180

PAYEE "B" RECORD—RECORD LAYOUT (USING ONE PAYMENT AMOUNT FIELD)—Continued
FORM W-2G

Sector 3

RECORD SEQUENCE	RECORD TYPE	BLANK	DATE WON	TRANSACTION	RACE	CASHIER
1	2	3—60	61—66	67—81	82—86	87—91

Sector 3 (Continued)

WINDOW	FIRST ID	SECOND ID	BLANK
92—96	97—111	112—126	127—180

PAYEE "B" RECORD—RECORD LAYOUT (USING TWO PAYMENT AMOUNT FIELDS)
Form W-2G

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYERS' ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—91	92—180

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK
1	2	3—42	43—82	83—111	112—113	114—122	123—180

Sector 3

RECORD SEQUENCE	RECORD TYPE	BLANK	DATE WON	TRANSACTION	RACE	CASHIER
1	2	3—60	61—66	67—81	82—86	87—91

Sector 3 (Continued)

WINDOW	FIRST ID	SECOND ID	BLANK
92—96	97—111	112—126	127—180

PAYEE "B" RECORD—RECORD LAYOUT (USING THREE PAYMENT AMOUNT FIELDS)
Form W-2G

Sector 1

RECORD SEQUENCE	RECORD TYPE	PAYMENT YEAR	DOCUMENT SPECIFIC CODE	BLANK	NAME CONTROL	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2	3—4	5	6—7	8—11	12	13—21

Sector 1 (Continued)

PAYERS' ACCOUNT NUMBER FOR PAYEE	PAYMENT AMOUNT 1	PAYMENT AMOUNT 2	PAYMENT AMOUNT 3	FIRST PAYEE NAME LINE	BLANK
22—31	32—41	42—51	52—61	62—101	102-180

Sector 2

RECORD SEQUENCE	RECORD TYPE	SECOND PAYEE NAME LINE	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE	BLANK
1	2	3—42	43—82	83—111	112—113	114—122	123—180

Sector 3

RECORD SEQUENCE	RECORD TYPE	BLANK	DATE WON	TRANSACTION	RACE	CASHIER
1	2	3—60	61—66	67—81	82—86	87—91

Sector 3 (Continued)

WINDOW	FIRST ID	SECOND ID	BLANK
92—96	97—111	112—126	127—180

SEC. 13. END OF PAYER "C" RECORD

.01 The Control total fields have been expanded from 12 to 15 positions. Adjust your programs accordingly.

.02 Write this record after the last payee "B" Record following the last Payer/Transmitter "A" Record. A mini-disk will contain more than one (1) End of Payer "C" Record if the last Payee "B" Record for more than one payer is reported on the same mini-disk.

.03 Each End of Payer "C" Record must contain a count of the number of Payee "B" Records immediately preceding the End of Payer "C" Record and following the preceding Payer/Transmitter "A" Record under which a Payer is reporting payments for a type of return. To illustrate:

(a) Single mini-disk; where all the records of a Payer for a particular type of return are reported on a single mini-disk, the last preceding Payer/Transmitter "A" Record would be the "A" Record immediately preceding the Payer's Payee "B" Records for which the End of Payer "C" Record has been written.

(b) Multiple mini-disk; where the reporting of a Payer for a particular type of return begins on one mini-disk and ends on another mini-disk, the last preceding Payer/Transmitter "A" Record would immediately precede all the Payee "B" Records on the diskette for which the Payer "C" Record has been written.

.04 Payers/Transmitters must verify the accuracy of the totals in the "C" Record and must enter the totals on the transmittal, Form 4804, which will accompany the shipment.

.05 The End of Payer "C" Record must be followed by a State Totals "K" Record or new Payer/Transmitter "A" Record for the next Payer (if any), or an End of Transmission "F" Record.

RECORD NAME: END OF PAYER "C" RECORD

Mini-Disk Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "C". Must be the 1st character of each END OF PAYER RECORD.
2-7	Number of Payees	6	REQUIRED. Enter the total number of payees ("B" Records) covered by the preceding Payer/Transmitter "A" Record. Right justify and zero fill.
8-22	Control Total 1	15	REQUIRED. Please note that all Control Total fields have been expanded from 12 to 15 positions. Enter accumulated totals from payment Amount 1. Right justify and zero fill. IF LESS THAN NINE AMOUNT FIELDS ARE BEING REPORTED, ZERO FILL UNUSED CONTROL TOTAL FIELDS.
	Control Total 2 through Control Total 9 are OPTIONAL. If any corresponding Payment Amount Fields are present in the Payee "B" Records, accumulate into the appropriate Control Total field. ZERO FILL UNUSED CONTROL TOTAL FIELDS. Please note that all Control Total fields have been expanded from 12 to 15 positions.		
23-37	Control Total 2	15	
38-52	Control Total 3	15	
53-67	Control Total 4	15	
68-82	Control Total 5	15	
83-97	Control Total 6	15	
98-112	Control Total 7	15	
113-127	Control Total 8	15	
128-142	Control Total 9	15	
143-180	Blank	38	REQUIRED. Enter blanks.

SEC. 14. END OF PAYER "C" RECORD—RECORD LAYOUT

SECTOR 1 (Please note that all Control Total fields have been expanded from 12 to 15 positions.)

RECORD TYPE	NUMBER OF PAYEES	CONTROL TOTAL 1	CONTROL TOTAL 2	CONTROL TOTAL 3	CONTROL TOTAL 4	CONTROL TOTAL 5
1	2—7	8—22	23—37	38—52	53—67	68-82

SECTOR 1 (Continued)

CONTROL TOTAL 6	CONTROL TOTAL 7	CONTROL TOTAL 8	CONTROL TOTAL 9	BLANK
83—97	98—112	113—127	128—142	143—180

SEC. 15. STATE TOTALS "K" RECORD

.01 The Control Total fields have been expanded from 12 to 15 positions. Adjust your programs accordingly.

.02 The State Totals "K" Record is a summary for a given payer and a given state in the Combined Federal/State Filing Program, used only when State Reporting approval has been granted.

.03 The "K" Record will contain the totals of the payment amount fields and the total number of payees filed by a given payer for a given state. The "K" Record(s) must be written after the "C" Record for the related "A" Record.

.04 There MUST be a separate "K" Record for each state being reported.

.05 Refer to Part A, Sec. 14 for the requirements and conditions that *MUST* be met to file on this Program.

RECORD NAME: STATE TOTALS "K" RECORD—Continued

Mini-Disk Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "K". Must be the 1st character of each STATE TOTALS "K" RECORD.
2-7	Number of Payees	6	REQUIRED. Enter the number of payees (different TINs) being reported to this state. Right justify and zero fill.
8-22	Control Total 1	15	REQUIRED. Please note that all Control Total fields have been expanded from 12 to 15 positions. Enter accumulated totals from Payment Amount 1. Right justify and zero fill. IF LESS THAN NINE AMOUNT FIELDS ARE BEING REPORTED, ZERO FILL UNUSED CONTROL TOTAL FIELDS.
	Control Total 2 through Control Total 9 are OPTIONAL. If any corresponding payment Amount fields are present in the Payee "B" Records, accumulate into the appropriate Control Total field. ZERO FILL UNUSED CONTROL TOTAL FIELDS. Please note that all Control Total fields have been expanded from 12 to 15 positions.		
23-37	Control Total 2	15	
38-52	Control Total 3	15	
53-67	Control Total 4	15	
68-82	Control Total 5	15	
83-97	Control Total 6	15	
98-112	Control Total 7	15	
113-127	Control Total 8	15	
128-142	Control Total 9	15	
143-178	Blank	36	REQUIRED. Enter blanks
179-180	State Code	2	REQUIRED. Enter the code for the state to receive the information.

SEC. 16. STATE TOTALS "K" RECORD—RECORD LAYOUT

SECTOR 1 (Please note that all Control Total fields have been expanded from 12 to 15 positions.)

RECORD TYPE	NUMBER OF PAYEES	CONTROL TOTAL 1	CONTROL TOTAL 2	CONTROL TOTAL 3	CONTROL TOTAL 4	CONTROL TOTAL 5
1	2—7	8—22	23—37	38—52	53—67	68—82

SECTOR 1 (Continued)

CONTROL TOTAL 6	CONTROL TOTAL 7	CONTROL TOTAL 8	CONTROL TOTAL 9	Blank	STATE CODE
83—97	98—112	113—127	128—142	143—178	179—180

SEC. 17. END OF TRANSMISSION "F" RECORD

.01 The "F" Record is a summary of the number of payers and mini-disks in the entire file.

.02 This record should be written after the last "C" Record (or "K" Record, when applicable).

.03 Only a Tape Mark or a Tape Mark and Trailer label may follow the "F" Record.

END OF TRANSMISSION "F" RECORD

Mini-Disk Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "F". Must be first character of END OF TRANSMISSION RECORD.
2-5	Number of Payers	4	REQUIRED. Enter total number of payers for this transmission. Right justify and zero fill.
6-8	Number of Mini-Disks	3	REQUIRED. Enter total number of mini-disks in this transmission. Right justify and zero fill.
9-30	Zero	22	REQUIRED. Enter zeroes.
31-180	Blank	150	REQUIRED. Enter blanks.

SEC. 18. END OF TRANSMISSION "F" RECORD—RECORD LAYOUT

RECORD TYPE	NUMBER OF PAYERS	NUMBER OF MINI-DISKS	ZERO	BLANK
1	2—5	6—8	9—30	31—180

PART D. BURROUGHS SUPER MINI-DISK II SPECIFICATIONS

SECTION 1. GENERAL

.01 The Burroughs Super Mini-Disk II is a flexible mylar disk with an iron oxide coating. The disk is 8 inches (20.3 cm) in diameter with a 1.5 inch (3.8 cm) center hole.

.02 There is one Index Hole which is used to indicate the beginning of a track on each side of the disk.

.03. Recorded data is encoded using the Miller Frequency Mode (MFM) technique. Data transferred between the disk and the processor is *NOT* encoded in any way. But serial data is written to the disk in a 180-byte sector format.

.04 Maximum bit density is 71 bits per inch.

.05 Track density is 150 tracks per inch.

.06 Data bytes per sector are 180.

.07 Data sectors per track are 60.

.08 Surfaces per disk are 2.

.09 When initializing the mini-disk, the name IRSTAX should be assigned to the mini-disk.

10. The file name in the mini-disk header label should be FED-MINI.

SEC. 2 THROUGH SEC. 18

See Super Mini-Disk Specifications contained in Part C. of this revenue procedure.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct liability.
(Also Part I, Sections 62, 162, 167, 170, 213, 217, 274, 1016; 1.62-1, 1.162-17, 1.167(a)-1, 1.170A-1, 1.213-1, 1.217-2, 1.274-5, 1.1016-3.)

Rev. Proc. 85-49[1]

SECTION 1. PURPOSE

This revenue procedure modifies Rev. Proc. 82-61, 1982-2 C.B. 849, as modified by Rev. Proc. 83-74, 1983-2 C.B. 593 and Rev. Proc. 84-72, 1984-2 C.B. 735, by increasing the optional standard mileage rate for the business use of an automobile and for the operation of an automobile in connection with rendering gratuitous services to a charitable organization under section 170 of the Internal Revenue Code for 1985. This revenue procedure also states that depreciation is considered to be allowed at 8 cents a mile for 1985 if the optional method for computing the costs of business use of an automobile is used.

SEC. 2. PROCEDURE

.01. Paragraph (1)(a) of subsection .01 of section 3 of Rev. Proc. 82-61, which was modified by Rev. Proc. 83-74, is further modified to read as follows:

Subject to the conditions and limitations set forth in section 3.01(2) below, with respect to transportation expenses paid or incurred after December 31, 1984, deductions will be accepted if computed at a standard mileage rate of (a) 21 cents a mile for the first 15,000 miles of use each year for business purposes, and (b) 11 cents of mile for use for business purposes in excess of 15,000 miles per year.

.02. Paragraph (2)(b) of subsection .01 of section 3 of Rev. Proc. 82-61, which was modified by Rev. Proc. 83-74 (inadvertently cited (2)(a)) and Rev. Proc. 84-72, is further modified to read as follows:

[1]Also released as News Release IR-85-95, dated September 19, 1985.

In the case of automobiles placed in service for business purposes after December 31, 1979, and in which the optional method was used in 1980, 1981, 1982, 1983, 1984, or 1985, depreciation will be considered to have been allowed at the rate of 7 cents a mile for 1980 and 1981, 7.5 cents a mile in 1982, and 8 cents a mile in 1983, 1984, and 1985, except that if the "actual cost" method was used for one or more of those years the rates above will not apply to any year in which that method was used. This depreciation will act to reduce the basis of the automobile in determining adjusted basis as required by section 1016 of the Code. An automobile placed in service after December 31, 1979, with respect to which the optional method is used is considered to have a useful life of 60,000 miles of business use at the maximum standard mileage rate determined without reference to the age of the vehicle. After 60,000 miles of business use at the maximum standard mileage rate, the automobile will be considered fully depreciated. For purposes of this paragraph, an automobile will be considered to have been driven no more than 15,000 miles in any one year, even though the actual business mileage of the automobile may be greater.

.03. Paragraph 1 of subsection .02 of section 3 of Rev. Proc. 82-61 is amended to read as follows:

With respect to transportation expenses paid after December 31, 1979, for the operation of an automobile in connection with obtaining medical care under section 213 of the Code, deductions will be accepted if computed at a standard mileage rate of 9 cents a mile. The standard mileage rate of 9 cents a mile will also be accepted with respect to such transportation expenses paid or incurred as moving expenses under section 217. With respect to transportation expenses paid after December 31, 1984, for the operation of an automobile in connection with rendering gratuitous services to a charitable organization under section 170, deductions will be accepted if computed at a standard mileage rate of 12 cents a mile. For expenses paid after December 31, 1979, but before January 1, 1985, the standard mileage rate is 9 cents a mile. Allowance of the standard mileage rate for any of these purposes is subject to the conditions and limitations set forth in the applicable sections of the Code.

SEC. 3. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 82-61, as modified by Rev. Proc. 83-74 and Rev. Proc. 84-72, is further modified.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 85-50

SECTION 1. BACKGROUND

Rev. Proc. 85-1, 1985-1 C.B. 440, contains in section 16 the Internal Revenue Service's practice regarding the rendering of oral advice to taxpayers.

SEC. 2. PROCEDURE

Rev. Proc. 85-1 is modified in section 16 to read as follows:

.01 The Service does not issue rulings or determination letters on oral requests. However, personnel in the rulings division ordinarily will discuss with taxpayers or their representatives inquiries regarding: substantive tax issues; whether the Service will rule on particular issues; and questions relating to procedural matters about submitting ruling requests (including the application of section 9, of this revenue procedure, to a particular case). Any discussion of substantive issues will be at the discretion of the Service on a time-available basis, and will not be binding on the Service.

.02 A taxpayer may seek oral technical assistance from a Taxpayer Service Representative in a District Office or Service Center when preparing a return or report, under other established procedures. Oral advice is advisory only and the Service is not bound to recognize it in the examination of the taxpayer's return.

SEC. 3. EFFECTIVE DATE

This revenue procedure is effective October 7, 1985, the date of its publication in the Internal Revenue Bulletin.

SEC. 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 85-1 is modified.

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26 CFR 601.602: Forms and instructions. (Also Part I, Sections 117, 4945; 1.117-1, 53.4945-4.)

Rev. Proc. 85-51

SECTION 1. PURPOSE

The purpose of this revenue procedure is to clarify Rev. Proc. 76-47, 1976-2 C.B. 670, and Rev. Proc. 80-39, 1980-2 C.B. 772, with regard to determining the number of employees' children who can be shown to be eligible recipients of employer-related educational grants or loans for purposes of the 10 percent test.

SECTION 2. BACKGROUND

.01 Rev. Proc. 76-47 provides guidelines to be used in determining whether a grant made by a private foundation under an employer-related educational grant program to a child of an employee of the particular employer to which the program relates is a scholarship or fellowship grant subject to the provisions of section 117(a) of the Code.

.02 Section 4 of Rev. Proc. 76-47 provides that if a private foundation's employer-related grant program satisfies seven conditions, and either a percentage test or a facts and circumstances test, the Service will assume that grants awarded under the program will be scholarship or fellowship grants subject to the provisions of section 117 of the Code. Section 4.08 of Rev. Proc. 76-47 provides that a program that awards grants to children of employees of a particular employer meets the percentage test if the number of grants awarded in any year to such children does not exceed 10 percent of the number of employees' children who can be shown to be eligible for grants (whether or not they submitted an application) in that year. An employee's child will be considered eligible only if that child meets all eligibility requirements imposed by the program and the requirements satisfy the conditions of section 4.03 of Rev. Proc. 76-47. Section 4.03 of Rev. Proc. 76-47 provides that, in the case of scholarships, the program must impose minimum eligibility requirements that limit the independent selection committee's consideration to those children of employees who meet the minimum standards for admission to an educational institution

(as defined in section 151(e)(4) of the Code) for which the grants are available. No persons will be considered eligible if they would not reasonably be expected to attend such an institution, however, even if they meet the minimum standards.

.03 Rev. Proc. 80-39 provides guidelines for determining whether educational loans made by a private foundation under an employer-related loan program are taxable expenditures under section 4945 of the Code.

.04 Section 4 of Rev. Proc. 80-39 provides that if a private foundation's employer-related loan program satisfies seven conditions, and either a percentage test or a facts and circumstances test, the Service will assume that loans awarded under the program will not be taxable expenditures under section 4945 of the Code. Section 4.10 of Rev. Proc. 80-39 provides that a program that awards loans to children of employees of a particular employer meets the percentage test if the number of loans awarded in any year to such children does not exceed 10 percent of the number of employees' children who can be shown to be eligible for loans (whether or not they submitted an application) in that year. An employee's child will be considered eligible only if that child meets all eligibility requirements imposed by the program and the requirements satisfy the conditions of section 4.05 of Rev. Proc. 80-39. Section 4.05 of Rev. Proc. 80-39 provides that the program must impose minimum eligibility requirements that limit the independent selection committee's consideration to those children of employees who meet the minimum standards for admission to an educational institution (as defined in section 151(e)(4) of the Code) for which the loans are available. No persons will be considered eligible if they would not reasonably be expected to attend such an institution, however, even if they meet the minimum standards.

SECTION 3. APPLICATION

The alternate 10 percent test under section 4.08 of Rev. Proc. 76-47 and section 4.10 of Rev. Proc. 80-39 is a safe harbor provision under which a private foundation may award educational grants or loans to 10 percent of the number of employees' children who can be shown to be eligible for a grant or loan in any year whether or not they applied for one. Therefore, application of the 10 percent test depends on whether the private foundation can determine how many employees' children are considered eligible, because the number of applications it received is not determinative. The eligibility requirements described in sections 4.03 and 4.05 or Rev. Proc. 76-47 and Rev. Proc. 80-39, respectively, are designed to ensure that, in determining how many employees' children are eligible, a private foundation only includes these persons who meet the minimum eligibility requirements imposed by the program and those persons who also meet the minimum standards for admission to an educational institution for which grants or loans are available.

Accordingly, for purposes of determining how many employees' children are eligible for a scholarship or loan under the 10 percent test, a private foundation may include as eligible only those children (1) who submit a statement in writing (or on whose behalf a statement is submitted by his/her authorized representative) or (2) for whom information is maintained sufficient to demonstrate, other than by statistical or sampling techniques, that (i) they meet the foundation's eligibility requirements; and (ii) they are enrolled in or have completed a course of study preparing them for admission to an educational institution at the level for which the scholarships or loans are available, have applied or intend to apply to such an institution, and expect, if accepted, to attend such an educational institution in the immediately succeeding academic year; or (iii) they currently attend an educational institution for which the scholarships or loans are available but are not in the final year for which an award may be made.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 76-47 and Rev. Proc. 80-39 are clarified.

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26 CFR 601.602: Forms and instructions. (Also Part I, Section 6050H.)

Rev. Proc. 85-52

PART A. GENERAL

SECTION 1. PURPOSE

.01 The purpose of this revenue procedure is to supplement existing requirements for reproducing paper substitutes of Forms 1099 by adding Form 1098, Mortgage Interest Statement.

.02 This revenue procedure supplements Rev. Proc. 85-25, 1985-1 C.B. 558.

SECTION 2. APPLICATION FOR APPROVAL OF SUBSTITUTE FORMS 1098 COPY A

.01 Paper substitutes for Forms 1098 that totally conform to the specifications contained in this procedure may be privately printed without prior approval from the Service.

.02 Proposed substitutes not conforming to these specifications must be submitted for consideration by the Service according to instructions in Rev. Proc. 85-25.

SECTION 3. INSTRUCTIONS

.01 All definitions and instructions in Part A of Rev. Proc. 85-25 that apply to Forms 1099 (other than Forms 1099-DIV, INT, OID and PATR) also apply to Forms 1098.

.02 Due to the nature of Form 1098 all references in Part A of Rev. Proc. 85-25 to "recipient" or "payee/recipient" should be substituted with "payer" and references to "payer" should be substituted with "recipient".

.03 Statements to "payers" must follow the specifications in Section 8.05 of Revenue Procedure 85-25 for copies to recipients. They may not be combined with Forms 1099-DIV, INT, OID, and PATR.

.04 Rev. Proc. 85-25 instructions for magnetic media filing of Forms 1099 also apply to Forms 1098.

PART B. SUBSTITUTE FORM FORMAT REQUIREMENTS FOR FORMS 1098

SECTION 1. GENERAL

.01 All Forms 1099 format requirements in Parts B and D of Rev. Proc. 85-25 also apply to Forms 1098. In addition, ink colors must be OCR dropout brown Sinclair-Valentine J-22053 (or exact match) or OCR dropout maroon Sinclair-Valentine J-31859 (or exact match) for tax year 1985 Forms 1098 only.

.02 The form identifying number for Forms 1098 is "8181".

.03 The specifications for Copy A of Forms 1098 is provided on Exhibit A.

.04 The "Instruction for Interest Recipients" as it appears on the back of copies C of the official form need not be reproduced on each copy. If one copy is provided to the recipient with each order of forms, the requirement to provide the instructions will have been met.

SECTION 2. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 85-25 supplemented.

NOTES:

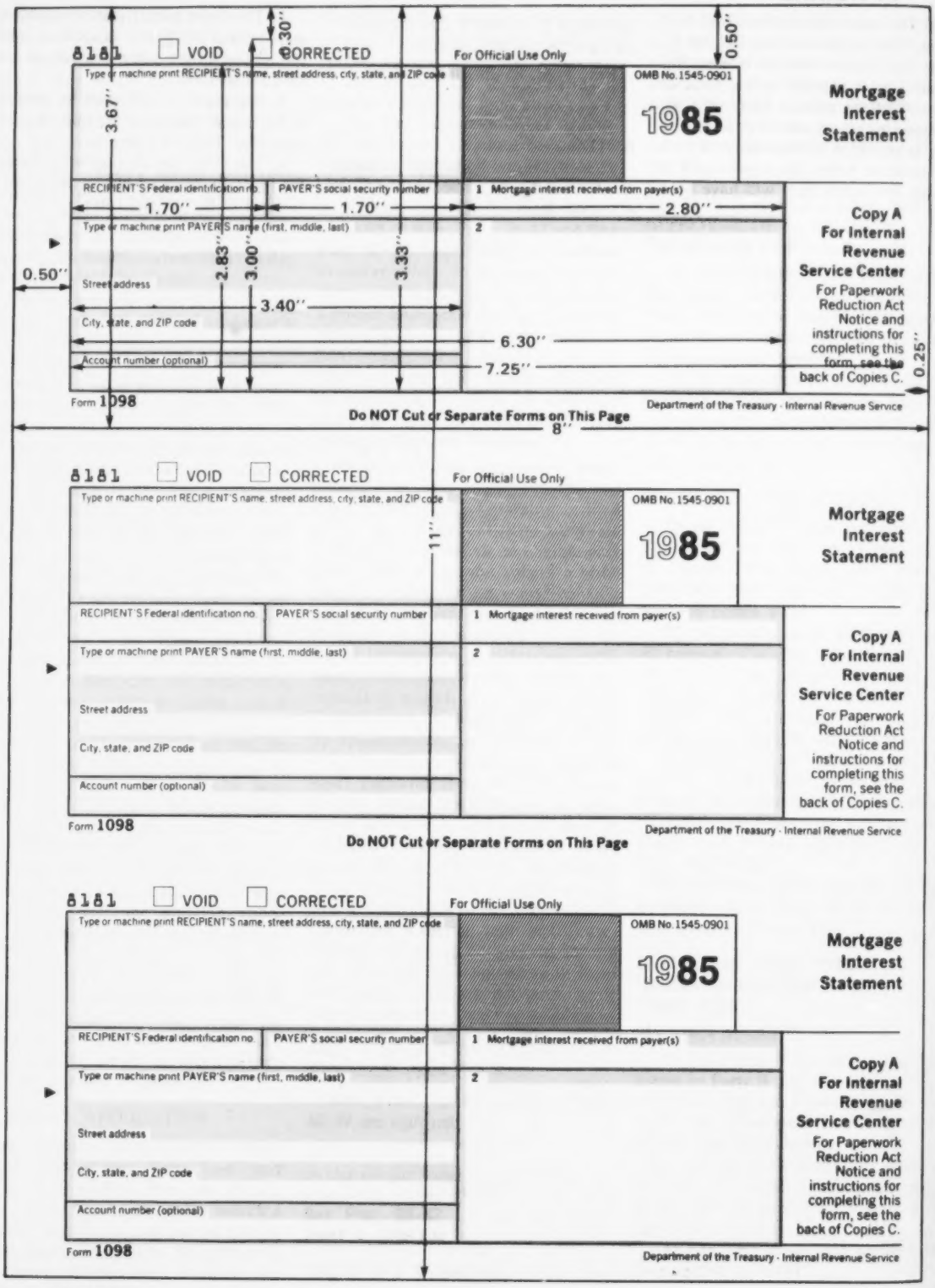
1. Vertical and horizontal measurements must be the same as the official 8'' width form.

2. The form identification number must consist of "8181" in OCR A font and placed in the same position as on the official form.

3. The printer's EIN must be printed in the botton margin of the face of each individual form of Copy A.

4. The titles for all numbered boxes for federally-required entries must correspond to the official form.

Exhibit A


8181 VOID CORRECTED
For Official Use Only
Type or machine print RECIPIENT'S name, street address, city, state, and ZIP code
OMB No. 1545-0901
1985
Mortgage Interest Statement
RECIPIENT'S Federal identification no.
PAYER'S social security number
1 Mortgage interest received from payer(s)
Type or machine print PAYER'S name (first, middle, last)
2
Street address
City, state, and ZIP code
Account number (optional)
Copy A For Internal Revenue Service Center
For Paperwork Reduction Act Notice and instructions for completing this form, see the back of Copies C.
Form 1098
Department of the Treasury · Internal Revenue Service
Do NOT Cut or Separate Forms on This Page
0.30"
0.50"
3.67"
1.70"
1.70"
2.80"
0.50"
2.83"
3.00"
3.33"
3.40"
6.30"
7.25"
0.25"
8"
11"

26 CFR 601.602: Tax forms and instructions. (Also Part I, Sections 1441, 1442, 1443, 1461, 1462, 1463, 1464, 6011; 1.1441-1, 1.1442-1, 1.1443-1, 1.1461-2, 1.1462-1, 1.1463-1, 1.1464-1, 1.6011-1.)

Rev. Proc. 85-53

PART A—GENERAL

SECTION 1. PURPOSE AND NATURE OF CHANGES

The purpose of this Revenue Procedure is to update and supersede Rev. Proc. 85-12, 1985-1 C.B. 500, that sets forth the requirements and conditions under which withholding agents, as defined in Section 2.01 below, may file Form 1042S information returns on magnetic tape.

For Tax Year 1985 Form 1042S has been revised. The most significant changes include the elimination of column (f) "Tax Released", consolidation of columns (e) "Amount of tax withheld" and (g) "Net Amount of tax withheld" into one column "Tax Withheld", and the addition of "Payer's name and employer identification number (if different from withholding agent's)".

The following changes have been included in this revenue procedure:

.01 The record size for all record types has been expanded from 393 positions to 450 positions.

.02 Part A, Section 3 .06 the mailing address for magnetic tape shipments has been changed.

.03 Part B, Section 2 .02 the definition of a Payer (as opposed to a Withholding Agent) has been included.

.04 Part B, Section 4 the references to the record length of the Transmitter "T" record have been changed from 393 positions to 450 positions.

.05 Part B, Section 4 Element 8, "MX" is no longer a valid State Code for the Transmitter's address.

.06 Part B, Section 4 Element 9, Zip Code of the Transmitting Agent, in the Transmitter "T" record has been expanded from 5 to 9 positions.

.07 Part B, Section 5 Element 7, Zip Code of the Withholding Agent, in the Recipient "Q" record has been expanded from 5 to 9 positions. This necessitates a shift in relative position for elements 8 and beyond in the Recipient "Q" record.

.08 Part B, Section 5 Element 10, Agent's ID Number, in the Recipient "Q" record has been expanded from 10 to 15 positions.

.09 Part B, Section 5 Element 11, Country Code list, Kampuchea has changed its name back to Cambodia, however the Country Code (CB) remains unchanged.

.10 Part B, Section 5 Element 28 in the Recipient "Q" record has been changed. Amount of Tax Released (element 28 last year) has been deleted and replaced with a new element "Payer's Name" consisting of 35 positions. For a definition of Payer, refer to Part B, Section 2 .02.

.11 Part B, Section 5 Element 29 in the Recipient "Q" record has been changed. Amount of Net Tax Withheld (element 29 last year) has been deleted and replaced with a new element "Payer's EIN".

.12 Part B, Section 5 Element 30, the reserved filler at the end of the Recipient "Q" record has been expanded to accommodate the increase in size of the Recipient "Q" record.

.13 Part B, Section 6, the references to the record length of the Withholding Agent "W" record have been changed from 393 positions to 450 positions.

.14 Part B, Section 6 Element 8, Zip Code of the Withholding Agent, in the Withholding Agent "W" record has been expanded from 5 to 9 positions. This necessitates a shift in relative position for elements 9 and beyond.

.15 Part B, Section 6 Elements 12, 13, and 14 in the Withholding Agent "W" record have been changed. "Total Tax Released" (Element 12 last year) and "Total Net Tax Withheld" (Element 13 last year) have been deleted and merged with last year's element 14 blank filler into a new element 12 consisting of blank filler.

.16 Part B, Section 7, the record length of the End of Reel "Z" record has been changed from 393 positions to 450 positions. Note that the format of the "Z" record is identical to the format of the "W" record as far as element positioning is concerned. Therefore, element 8 (Zip Code) will also expand in the "Z" record from 5 positions to 9 positions, and elements 12, 13, and 14 from last year's format have been merged into a new element 12 of blank filler.

.17 Part B, Section 8, the references to the record length of the End of Transmission "Y" record have been changed from 393 positions to 450 positions.

SEC. 2. APPLICATION FOR TAPE REPORTING

.01 A withholding agent is defined as any person or entity, U.S. or foreign, required to withhold U.S. tax on payments of income subject to withholding from sources within the United States as provided for in Chapter 3 of the Internal Revenue Code. A withholding agent may be an individual, partnership, corporation, trust, estate, government agency (Federal, State or local), association, or a tax-exempt foundation or organization.

.02 The Internal Revenue Service encourages any entities who must file information returns and who have facilities for submitting this information on magnetic tape to use this method of filing. Withholding agents filing Form 1042S information returns in the form of magnetic tape should also be aware of the current revenue procedures relating to magnetic tape reporting for wage and information documents, diskpack reporting for wage and information documents, and diskette reporting for wage and information documents. Copies of these revenue procedures are available from any Internal Revenue Service Center.

.03 Form 1042S statements may be filed on magnetic tape by withholding agents or by their agents. Tape reporting is not restricted to withholding agents with the ability to submit all their information on magnetic tape. A combination of tape records and paper documents is acceptable so long as there is no duplication or omission of documents.

.04 Withholding agents or their agents who desire to file statements in the form of magnetic tape must first file Form 4419, Application for Magnetic Media Reporting of Information. Mail the application to:

Director, Philadelphia Service Center,
Internal Revenue Service
P.O. Box 245
Bensalem, Pennsylvania 19020
Attention: Magnetic Media Coordinator.

The application must contain the following:

(a) Name, address, and Employer Identification Number (EIN) of person, organization or entity making the request.

(b) Name, title, and telephone number of person to contact regarding the request.

(c) An estimate of the number of Form 1042S statements to be reported in tape format, and the number, if any, to be reported on paper forms.

(d) Type and nature of equipment to be used to prepare tape, (i.e. manufacturer and model of main frame and tape drives, tape width (1/2", 3/4", etc.) density (character per inch), and recording mode (BCD, ASCII, EBCDIC, etc.).

(e) List of withholding agent(s) to be included in the file(s) if the requestor is a transmitter or Service Bureau that is filing for a group of withholding agents. This list must include each withholding agent's name, complete address (including Zip Code), and EIN. The list should be in EIN sequence.

(f) Signature of official responsible for the preparation of tax reports or his authorized agent.

.05 The Service will act on applications and notify applicants of authorization or disapproval within 30 days of receipt of applications.

.06 Generally, withholding agents using equipment compatible with the Service's can presume that their application will be approved. Compatible tape characteristics are shown in PART "B", Section 1.01. Where the capability to prepare several types of tapes exits, the Service prefers that compatible tapes be prepared.

.07 If withholding agents propose to submit convertible tapes, the Service will attempt to find conversion facilities. Generally, an application to file on magnetic tape will be disapproved only when the Service is unable to obtain facilities to convert a withholding agent's file to a compatible form.

.08 In general, once authorization to file on magnetic tape has been granted, such approval will continue in effect in succeeding years, providing that the requirements of this Revenue Procedure are met and there are no equipment changes by the withholding agent or transmitter. However, new applications are required:

(a) If the filers change from equipment producing compatible tapes to equipment producing convertible tapes.

(b) If the filers submit tapes that are not listed as either compatible or convertible.

(c) If the filers discontinue tape reporting for one or more years, then decide to resume this method of reporting.

SEC. 3. FILING OF TAPE REPORTS

.01 Packaging, shipping, and mailing instructions will be provided in the authorizing letter issued by the Service in response to an application for tape reporting.

.02 Withholding agents submitting a portion of their statements on magnetic tape and the remainder on paper forms, should file both magnetic tape records and paper documents at the Philadelphia Service Center, but in separate shipments.

.03 The withholding agent's Form 1042 tax return serves as the transmittal document for Form 1042S statements, including those on paper and on magnetic tape. For transmitters of Service Bureaus filing statements on tape for several withholding agents, separate Forms 1042 must be filed by each withholding agent included in the transmittal. Since the required Form 1042 is a tax return (with or without a remittance attached), it must be filed separately from the shipment of magnetic tape. Any additional documents required to be submitted should accompany Form 1042. (See instructions for Form 1042, U.S. Annual Return of Income Tax to Be Paid At Source under Chapter 3. Internal Revenue Code.)

.04 The dates prescribed for filing paper documents with the Service will also apply to magnetic tape filing. Requests for extensions of time for filing and related matters should be made to the Director, Philadelphia Service Center. If an extension has been granted by the Service, a copy of the letter granting the extension should be attached to the Form 1042.

.05 Enclose a transmittal in triplicate, in the first box of the tape shipment, with the following information:

(a) The complete name, address, and EIN of the transmitter of the tape file.

(b) Name, address, title, and telephone number of the person to contact regarding any tape file problem.

(c) The complete name and address to be used in returning the tape file.

(d) The manufacturer and model of the main frame and tape drives, the tape width, the density in characters per inch, and the recording code (BCD, Excess 3, Octal, etc.).

(e) The type of document being reported—i.e. Form 1042S.

(f) Total number of tape reels in the file.

.06 Ship to:

Internal Revenue Service Center
11601 Roosevelt Blvd.
Philadelphia, PA 19155
Attn: Magnetic Media Coordinator

Note on the address side of the shipment:

"EXPEDITE FORM 1042S STATEMENTS ON MAGNETIC TAPE, DELIVER UNOPENED TO TAPE LIBRARY.

.07 The magnetic tape specifications contained in PART "B" of this Revenue Procedure must be strictly adhered to. Deviations will not be permitted under any circumstances. All magnetic tape filings will be scanned for completeness of required fields, mathematical verification, and proper format. Tapes failing to meet specifications will not be processed, but will be returned to the transmitter for correction at the discretion of the Director, Philadelphia Service Center.

SEC. 4. PROCESSING OF TAPE STATEMENTS

.01 The Service will copy the information from the original tapes and will return the original tapes to the transmitter. Normally, tapes will be returned by September 15 of the year in which submitted. However, if the tapes submitted are unprocessable, and must be returned for correction prior to processing, they will be returned within six months of the receipt of acceptable tapes. We suggest that the withholding agent retain the original tape until the expiration of the statute of limitations for assessment.

.02 The Service will prepare the appropriate statements for transmittal to treaty countries.

SEC. 5. CORRECTED STATEMENTS

.01 The appropriate paper forms will

normally be used if it is necessary to correct Recipient "Q" records in the magnetic tape files. Since corrected statements supersede information previously supplied, all required data fields must be completed. Annotate each form "Corrected" at the top. Corrected documents should be bundled separately from other paper documents. When correcting documents are shipped separately, an amended Form 1042 must be filed, also suitably annotated.

.02 If the withholding agent discovers that a large volume of records submitted have to be corrected, the service center magnetic tape coordinator should be contacted. He/She should ask that the original tape be returned so that the corrections can be made to it. If the service center has already processed the tape, paper documents must be prepared for the ones needing corrections.

SEC. 6. EFFECT ON PAPER DOCUMENTS

.01 Magnetic tape reporting to Internal Revenue Service eliminates the need for submission of paper Forms 1042S. However, withholding agents must continue to provide recipients with requisite information, although this need not be on a copy of Form 1042S.

.02 If only a portion of the statements are reported on magnetic tape and the remainder are reported on paper forms, those paper statements must be filed on the prescribed forms.

SEC. 7. DATA ENTRIES

.01 Since taxpayer identifying numbers are not required on all Forms 1042S (see specific Instructions for Withholding Agents, Copy C of the official Form 1042S), the specifications in PART "B" of this Revenue Procedure permit omission of such identifying numbers. Although identifying numbers are not always required for nonresident alien income recipients, the Service appreciates their being furnished when available.

.02 Recipient surnames are used to computer-generate Sort Names. Use an asterisk to indicate the beginning of the surname for this purpose. If the surname is the first name on the line, as may be the case for nationals of Asian countries, the asterisk is to be omitted. In the case of a partnership or joint ownership, or some other case where more than one individual is listed, asterisk only the first surname. A blank will always precede the asterisk when it is used, but no asterisk may be followed by a blank. Do not use an asterisk with corporate or any other business entity or governmental organization name, except partnerships or sole proprietorships.

.03 In case of multiple recipients, the name of the person whose identifying number has been provided should be placed before all other names.

.04 Sometimes the recipient identification recorded on the withholding agent's records is lengthy, and exceeds the 105 characters allotted in the Recipient Name Line and Supplemental Name Lines on the magnetic tape records. This is most common in the case of trusts or other types of fiduciary accounts. The first 105 characters of the recipient identification normally provide sufficient descriptive data for the Service's purposes. The Service encourages all agents to truncate or abbreviate lengthy recipient descriptions.

.05 All monetary amount fields must show dollars and cents (omit the decimal point). For example, $135.72 must be shown as 13572, and $100 must be shown as 10000. All money amount fields are positive and must not be signed in any fashion. All money amounts must be right-justified and zero filled. Do not truncate any money amount fields. If the amount is more than the allowed space, prepare a second "Q" record to show the difference.

SEC. 8. ADDITIONAL INFORMATION

Requests for additional copies of this Revenue Procedure, or requests for additional information on tape reporting, should be addressed to:

Internal Revenue Service
Post Office Box 245
Bensalem, Pennsylvania 19020
Attention: Magnetic Media
Coordinator

PART "B"—MAGNETIC TAPE SPECIFICATIONS

SECTION 1. GENERAL

.01 These specifications prescribe the required format and content of the records to be included in the file, but not the methods or equipment to be used in their preparation. Usually, the Service will be able to process, without translation, any compatible tape file. To be compatible, a tape file must meet all of the following:

Type of Tape—1/2inch Mylar base, oxide coated

Interrecord Gap—

.75 inch for 556 or 800 bpi density 7-trac,

.6 inch for 800 bpi density 9-track,

.6 inch for 1600 bpi density,

.3 inch for 6250 bpi density 9-track

(a) When the Recording Mode is EBCDIC (Extended Binary Coded Decimal Interchange Code):

(1) Parity—Odd Parity

(2) Recording Density—800, 1600, or 6250 Densities

(3) 9 Channel

(b) When the Recording Mode is ASCII (American Standard Coded Information Interchange):

(1) Parity—Odd Parity

(2) Recording Density—800, 1600, or 6250 Densities

(3) 9 Channel

(c) When the Recording Mode is BCD (Binary Coded Decimal):

(1) Parity—Odd or Even Parity

(2) Recording Density—556 or 800 Densities

(3) 7 Channel or 9 Channel

.02 An acceptable tape file for each withholding agent will contain data records as follows:

(a) Single reel:

(1) a Transmitter "T" record; then

(2) one or more Recipient "Q" records followed by a specific Withholding Agent "W" record; then

(3) additional "Q" and "W" record sequences for other withholding agents as needed; then

(4) an End of Transmission "Y" record.

(b) Multiple Reels:

(1) a Transmitter "T" record at the beginning of each reel; then

(2) sequences of Recipient "Q" records followed with corresponding Withholding Agent "W" records; then

(3) an End of Reel "Z" record on every reel except the last; and

(4) an End of Transmission "Y" record ending the last reel.

(c) Notes:

(1) a sequence of Recipient "Q" records may be continued from one reel to the next if they apply to the same withholding agent, without the necessity of repeating the "W" record. The sequence might be, for example, QQQQZ (end of one reel); TQQQQW (beginning of next reel).

(2) the End of Reel "Z" record is identical to the Withholding Agent "W" record, except that it indicates the end of the reel, but not necessarily the end of a withholding agent's "Q'; records. For example, when end of reel will be reached before the end of an agent's "Q" records, the "Z" record will be used in lieu of a "W" record. The next tape reel will begin with a "T" record, followed by the remaining "Q" records for the withholding agent.

.03 Affix an external label to each tape with the following information:

(1) Name of Transmitter.

(2) Number of "Q" records on that reel.

(3) Density (556, 800, 1600 CPI, etc.).

(4) Channel (7 or 9).

(5) Recording Mode (EBCDIC, ASCII, etc.).

(6) Parity (odd or even).

(7) Manufacturer and model of mainframe and tape drives

(8) Sequence number of reel, and total reels in the file (i.e. 1 of 3, 2 of 4, etc).

.04 All records, including Header and Trailer labels (if used) must be transmitted at the same density.

.02 Definitions:

Element	*Description*
b	Denotes a blank position. For compatibility with Service equipment, if using BCD recording mode, use BCD bit configuration 010000 ("A" bit only) in even parity, 001101 ("841" bits) in odd parity.
Special Character	Any character that is not a numeral, a letter, or a blank.
Withholding Agent	Person or organization, including withholding agent, responsible for paying income and withholding taxes. The withholding agent is responsible for the completeness, accuracy, and timely submission of magnetic tape files.
Payer	Person or organization who is the originator of income and enters into a contractual agreement with the withholding agent for the purpose of disbursing income for the payer. For example, Corporation X is about to declare a dividend. Corporation X contracts Bank Y to calculate and distribute such dividends to recipients, and be responsible for withholding. Corporation X is considered the Payer and Bank Y is considered the Withholding Agent.
Transmitter	Person or organization preparing and filing tape files. May be the withholding agent or his agent.
Recipient	Person(s) or organization(s) receiving payments from a withholding agent.
Record	A group of related fields of information treated as a unit.
Blocked Records	Two or more records grouped together between interrecord gaps.
File	For the purpose of this Procedure, a file consists of all tape records submitted by a transmitter.
Reel	A spool of magnetic tape.
EIN	Employer Identification Number that has been assigned by the Service to the particular entity.
SSN	Social Security Number.

SEC. 2. CONVENTIONS AND DEFINITIONS

.01 Header Labels, Trailers Labels, Record Marks and Tape Marks are all optional. They may be used as required by the transmitter's equipment or programming. If used they must conform to the following standards:

(a) Header Labels must begin VOL1, VOL2, HDR1, HDR2, or 1HDR. If used, they must be the first record(s) on the reel immediately before the Transmitter "T" record. Header labels may not exceed 80 characters in length.

(b) Trailer Labels must begin 1EOR, 1EOF, EOF1, or EOR1. If used, they must be the last record(s) on the reel, after the "Z" or "Y" record and Tape Mark (if a Tape Mark is used). Trailer Labels may not exceed 80 characters in length.

(c) Record Marks, if used, may only follow the data portion of a record or block. All records are of uniform length, and record marks are not needed.

(d) Tape Marks, if used, must be IBM 001111 (Octal 17) in even parity. They always appear immediately after the "Z" or "Y" record. If Header and Trailers Labels are also used, the tape mark must follow the Header Label and must precede and/or follow the Trailers Label(s).

SEC. 3. RECORD LENGTH AND BLOCKING

.01 Tape records prescribed in the specifications may be blocked or unblocked, subject to the following:

(a) All data records are of a fixed length (450 positions).

(b) All records may be blocked, except Header and Trailer Labels.

(c) A block may not exceed 15,000 characters, although shorter blocks may be written as desired. If records are being blocked, but sufficient records are not available to fill a complete block, the block may either be "padded" with 9's to fill all unused positions or truncated after the last data record ("short block"). Do not pad the block with blanks, or create blank records (for example, Q followed by 449 blanks, etc.).

(d) Two forms of blocking are acceptable:

(1) Only "Q" Records are acceptable:

(2) All records, except Header and Trailer Labels, if used, are blocked. In this case, a "T" Record may only be the first record in the first block on the reel (first reel only); a "W" Record must follow all associated "Q" Records; and, "Y" or "Z" Records may only be the last record in the last block on the reel (only block padding (all 9's) could follow).

.02 The first position of each record indicates the record type:

Transmitter	T
Recipient	Q
Withholding Agent	W
End of Reel	Z
End of Transmission	Y

.03 The minimum file transmitted must consist of a Transmitter "T" record, a Recipient "Q" Record, a Withholding Agent "W" Record, and an End of Transmission "Y" Record.

SEC. 4. THE TRANSMITTER "T" RECORD

This record identifies the entity who prepares and transmits the magnetic tape file. The Transmitter and one of the withholding agents may be the same, but they need not be. The Transmitter "T" Record must be the first data record on a reel (preceded only by header labels, if any), and must appear on each reel in the file sent by the Transmitter. On multiple reel files the reel number must be incremented by 1 (one) for each tape reel after the first reel. Each "T" Record has a fixed length of 450 positions. The elements of data prescribed for each "T" Record are as follows:

Element	*Positions*	*Title*	*Description*
1	1	Record Type	Enter letter "T"
2	2 & 3	Tax Year	Enter the last two digits of the year for which income and withholding is being reported. All recipient "Q" and transmitter "T" Records on the file for every withholding agent *must* report payments for this year, and this year *only*. Transmit separate Forms 1042 and tape files for different tax years.
3	4 & 5	Reel Number	The two-digit serial number assigned by the Transmitter to this reel, starting with 01. If Header Labels are used, this should be the same as the Reel Sequence Number.
4	6–14	EIN	Enter the Employer Identification Number of the *Transmitter*. Omit hyphen.
5	15–54	Transmitter Name	Enter name of submitter of file; left justify and blank fill. Abbreviate if necessary to fit 40-character limit. Omit punctuation marks except hyphens and ampersands.
6	55–94	Street Address	Enter Street Address, PO Box, or other location of Transmitter. Left justify and blank fill. Abbreviate as needed to fit 40-character limit.
7	95–114	City	Enter City, Town, APO/FPO, etc. of Transmitter. Left justify and blank fill. Abbreviate to fit 20-character limit.
8	115 & 116	State Code	Enter two-letter PO Code as shown in the list below *only*. Do not spell out any state name.

State Codes

STATE	*CODE*	*STATE*	*CODE*	*STATE*	*CODE*
Alabama	AL	Hawaii	HI	Michigan	MI
Alaska	AK	Idaho	ID	Minnesota	MN
Arizona	AZ	Illinois	IL	Mississippi	MS
Arkansas	AR	Indiana	IN	Missouri	MO
California	CA	Iowa	IA	Montana	MT
Colorado	CO	Kansas	KS	Nebraska	NE
Connecticut	CT	Kentucky	KY	Nevada	NV
Delaware	DE	Louisiana	LA	New Hampshire	NH
District of Columbia	DC	Maine	ME	New Jersey	NJ
Florida	FL	Maryland	MD	New Mexico	NM
Georgia	GA	Massachusetts	MA	New York	NY

State Codes

STATE	*CODE*	*STATE*	*CODE*	*STATE*	*CODE*
North Carolina	NC	Utah	UT	Virgin Islands	VI
North Dakota	ND	Vermont	VT		
Ohio	OH	Virginia	VA		
Oklahoma	OK	Washington	WA		
Oregon	OR	West Virginia	WV		
Pennsylvania	PA	Wisconsin	WI		
Rhode Island	RI	Wyoming	WY		
South Carolina	SC	American Samoa	AS		
South Dakota	SD	Canada	CD		
Tennessee	TN	Guam	GU		
Texas	TX	Puerto Rico	PR		

Notes:

(1) For other Foreign countries use XX

(2) APO & FPO addresses *must* show a city, state, and Zip. Do *not* use "XX" for APO & FPO: the four permissible State codes are "NY", "CA", "WA", and "FL".

Elements	*Positions*	*Title*
9	117–125	ZIP Code
10	126–450	Blanks

Description

Enter the Zip Code of the Transmitter for all U.S., U.S. Territory or possession, APO/FPO addresses. For Transmitters using a 5 digit zip code, enter the zip code in the left most 5 positions and zero fill the remaining 4 positions. For Transmitters outside the U.S. enter nine zeros only. DO NOT blank fill. Blank fill the rest of the "T" Record.

Blank fill the rest of the "T" Record.

SEC. 5. RECIPIENT "Q" RECORD

This Record contains complete name and address data for both Withholding Agent and Recipient of Income, together with all the particulars of the income paid and tax withheld. Complete Withholding agent data is required because each Recipient "Q" Record is treated as if it were a separate Form 1042S, and is processed independently of other records. Since the "Q" Record is restricted to one type of income only, it may be necessary to write more than one "Q" Record (up to 23) for any given individual income recipient, who may have received income of more than one type. All recipient "Q" Records for a particular Withholding Agent must be written before the corresponding Withholding Agent "W" Record, and before "Q" Records for another Withholding Agency may begin. Any order of "Q" Records within those belonging to a given Withholding Agency may be used (for example, they may be sorted alphabetically by surname, or by country code, or by country of the mailing address, etc.) at the convenience of the Transmitter or Withholding Agent, since the "Q" Records are fully independent. All "Q" Records have a fixed length of 450 positions. All Elements are required unless otherwise stated.

Element	*Positions*	*Title*
1	1	Record Type
2	2–10	Agent EIN
3	11–45	Agent Name
4	46–80	Agent Address
5	81–100	City
6	101 & 102	State Code
7	103–111	Zip Code

Description

Enter Q only.

Enter the 9-digit Employer Identification Number of the Withholding Agent. Omit the hyphen.

Enter the name of the Withholding Agent up to the limit of 35 characters. Abbreviate as needed, omitting punctuation Left justify and blank fill.

Enter Street address, PO Box, or other location of the Agent to a limit of 35 characters. Abbreviate as needed, omitting punctuation. Left justify and blank fill.

Enter the city or town (or other locality name) up to the limit of 20 characters. Left justify and blank fill.

Enter the two-character alphabetic code in the list in Sec. 4., above. *DO NOT* use CD (Canada), MX (Mexico), or XX (Other foreign country). If the state is not a U.S. state, blank fill this field and use the Country Code field (Element 11) to identify the foreign address. Do not spell out any state name.

Enter 9 numeric characters for all U.S. Addresses (including territories, possessions, and APO/FPO). If a 5 digit zip code is used, enter the zip code in the leftmost

Element	*Positions*	*Title*	*Description*
			5 positions and zero fill the remaining 4 positions. Zero fill for addresses outside the U.S.
8	112	Account Type Code	Enter "1" for U.S. business or organization; Element 9 must have an EIN. Enter "2" for U.S. citizen or resident alien; Element 9 must have SSN. Enter "3" for nonresident alien persons, businesses, or organizations. Element 9 should contain an EIN or SSN if one is available. Enter "4" if "1" or "2" applies, but an SSN or EIN is not available for a legitimate reason; for example, a number has been applied for but not received.
9	113–121	TIN	Enter the recipient's U.S. identification number; if Element 8 has a "1" you must enter an EIN; if Element 8 has a "2" you must enter an SSN; if Element 8 has a "3", enter an EIN or SSN if available—otherwise enter blanks; if Element 8 has a "4" you must enter blanks.
10	122–136	Agent's ID Number	Enter the account number assigned by the Withholding agent for this recipient up to a maximum of 15 positions. This number is used to facilitate identification of the specific record if there is any correspondence. Left justify and blank fill. This Element will be all blank if account numbers are not assigned. This field may contain numeric or alphabetic characters, blanks, or hyphens.
11	137 & 138	Country Code	Enter two alphabetic characters from the list below which represents the official country for which Tax Treaty benefits are based. This may or may not be the same as the country given in Element 20, below. Entry of a true country code is mandatory. "OC" (country unknown or not identified) is to be used with great reluctance. THE TAPE FILE WILL BE RETURNED FOR CORRECTION AT THE DISCRETION OF THE SERVICE CENTER DIRECTOR IF A SUBSTANTIAL NUMBER OF "Q" RECORDS SHOW COUNTRY CODE "OC". WHENEVER COUNTRY CODE "OC" IS USED, THE RATE OF TAX WITHHELD MUST EQUAL 30%.

Country	Code	Country	Code	Country	Code
Afars & Issas (now Djibouti)	DJ	Bangladesh	BG	Burkina (formerly Upper Volta)	UV
Afghanistan	AF	Barbados	BB	Burma	BM
Albania	AL	Bassas da India	BS	Burundi	BY
Algeria	AG	Belgium	BE	Cambodia (formerly Kampuchea)	CB
American Samoa	AQ	Belize (formerly British Honduras)	BH	Cameroon	CM
Andorra	AN	Benin (formerly Dahomey)	BN	Canada	CA
Angola	AO	Bermuda	BD	Canary Islands	SP
Anguilla	AV	Bhutan	BT	Canton & Enderbury Islands (now Kiribati)	KR
Antarctica	AY	Bolivia	BL	Cape Verde	CV
Antigua & Barbuda	AC	Botswana	BC	Cayman Islands	CJ
Argentina	AR	Bouvet Island	BV	Central African Republic	CT
Ashmore & Cartier Is.	AT	Brazil	BR	Ceylon (now Sri Lanka)	CE
Australia	AS	British Honduras (now Belize)	BH	Chad	CD
Austria	AU	British Indian Ocean Territory	IO	Chile	CI
Azores	PO	British Virgin Islands	VI	China, Peoples Republic (Mainland China)	CH
Bahamas, The	BF	Brunei	BX		
Bahrain	BA	Bulgaria	BU		

Country	Code
China (Taiwan)	TW
Christmas Island	KT
Clipperton Island	IP
Cocos (Keeling) Islands	CK
Colombia	CO
Comoros	CN
Congo	CF
Cook Islands	CW
Coral Sea Islands Terr.	CR
Costa Rica	CS
Cuba	CU
Cyprus	CY
Czechoslavkia	CZ
Denmark	DA
Djibouti (formerly Afars & Issas)	DJ
Dominica	DO
Dominican Republic	DR
Ecuador	EC
Egypt	EG
Ellice Islands (now Tuvalu)	TV
El Salvador	ES
England	UK
Equatorial Guinea	EK
Ethiopia	ET
Europa Island	EU
Falkland Islands (also known as Islas Malvinas)	FA
Faroe Islands	FO
Fiji	FJ
Finland	FI
France	FR
French Guiana	FG
French Polynesia	FP
French Southern & Antarctic Lands	FS
Gabon	GB
Gambia, The	GA
Gaza Strip	GZ
German Democratic Republic (East Germany)	GC
Germany, Federal Republic of (West Germany)	GE
Ghana	GH
Gibraltar	GI
Gilbert Islands (Kiribati)	KR
Glorioso Islands	GO
Greece	GR
Greenland	GL
Grenada	GJ
Grenadine Islands (& St. Vincent)	VC
Guadeloupe	GP
Guam	GQ
Guatemala	GT
Guernsey	GK
Guinea	GV
Guinea-Bissau	PU
Guyana	GY
Haiti	HA
Heard Island & McDonald Islands	HM
Holland (Netherlands)	NL
Honduras	HO
Hong Kong	HK
Hungary	HU
Iceland	IC
India	IN
Indonesia	ID
Iran (formerly Persia)	IR
Iraq	IZ
Iraq-Saudi Arabia Neutral Zone	IY
Ireland	EI
Isle of Man	IM
Israel	IS
Italy	IT
Ivory Coast	IV
Jamaica	JM
Jan Mayen	JN
Japan	JA
Jersey	JE
Johnston Atoll	JQ
Jordan	JO
Juan de Nova Island	JU
Kampuchea (now Cambodia)	CB
Kenya	KE
Kingman Reef	KQ
Kiribati (Canton & Enderbury & Gilbert Is.)	KR
Korea, Democratic Peoples Republic of (North Korea)	KN
Korea, Republic of (South Korea)	KS
Kuwait	KU
Laos	LA
Lebanon	LE
Lesotho	LT
Liberia	LI
Libya	LY
Liechtenstein	LS
Luxembourg	LU
Macau	MC
Madagascar	MA
Malawi	MI
Malaysia	MY
Maldives	MV
Mali	ML
Malta	MT
Martinique	MB
Mauritania	MR
Mauritius	MP
Mayotte	MF
Mexico	MX
Midway Islands	MQ
Monaco	MN
Mongolia	MG
Montserrat	MH
Morocco	MO
Mozambique	MZ
Namibia (SW Africa)	WA
Nauru	NR
Navassa Island	BQ
Nepal	NP
Netherlands (Holland)	NL
Netherlands Antilles	NA
New Caledonia	NC
New Hebrides (Vanuatu)	NH
New Zealand	NZ
Nicaragua	NU
Niger	NG
Nigeria	NI
Niue	NE
Norfolk Island	NF
Northern Ireland	UK
Northern Marina Islands	CQ
Norway	NO
Oman	MU
Pakistan	PK
Palmyra Atoll	LQ
Panama (except Canal Zone)	PM
Papua-New Guinea	PP
Paracel Islands	PF
Paraguay	PA
Peru	PE
Philippines	RP
Pitcairn Islands	PC
Poland	PL
Portugal	PO
Portuguese Timor (Indonesia)	ID
Puerto Rico	RQ
Qatar	QA
Reunion	RE
Romania	RO
Rwanda	RW
St. Christopher-Nevis (also called St. Kitts)	SC
St. Helena	SH
St. Lucia	ST
St. Pierre & Miquelon	SB
St. Vincent & the Grenadines	VC
San Marino	SM
Sao Tome and Principe	TP
Saudi Arabia	SA
Scotland	UK
Senegal	SG
Seychelles	SE
Sierra Leone	SL
Singapore	SN
Solomon Islands	BP
Somalia	SO
South Africa	SF
Southern Rhodesia (now Zimbabwe)	ZI
South-West Africa (now Namibia)	WA
Spain	SP
Spratly Islands	PG
Sri Lanka (formerly Ceylon)	CE
Sudan	SU
Suriname	NS
Svalbard	SV
Swaziland	WZ
Sweden	SW

County	Codes	County	Codes	County	Codes
Switzerland	SZ	Turks & Caicos Islands	TK	Wake Island	WQ
Syria	SY	Tuvalu (Ellice Islands)	TV	Wales	UK
Taiwan	TW	Uganda	UG	Wallis & Futuna	WF
Tanzania, United Republic of	TZ	Union of Soviet Socialist		West Bank	WE
Thailand	TH	Republics	UR	Western Sahara	WI
Togo	TO	United Arab Emirates	TC	Western Samoa	WS
Tokelau	TL	United Kingdom	UK	Yemen (South) (Aden)	YS
Tonga	TN	Upper Volta (now Burkina)	UV	Yemen (North) (Sanaa)	YE
Trinidad & Tobago	TD	Uruguay	UY	Yugoslavia	YO
Tromelin Island	TE	Vanuatu (New Hebrides)	NH	Zaire	CG
Trust Territory of the Pacific		Vatican City	VT	Zambia	ZA
Islands	NQ	Venezuela	VE	Zimbabwe	ZI
Tunisia	TS	Vietnam	VM	(Other Countries)	OC
Turkey	TU	Virgin Islands (US)	VQ		

Element	Positions	Title	Description
12	139–173	1st Name Line	Enter full name of recipient, or if there are more than one, the name of the first recipient only. Use an asterisk to indicate the surname as shown in Section 7.02 above. Valid characters are alphabetic, numeric, ampersand (&), hyphen(-), slash(/), asterisk(*), or blank. A name MUST be entered here; if the recipient is a numbered bank account, and the true recipient is not known, the account number must be supplied here. THE TAPE FILE WILL BE RETURNED FOR CORRECTION AT THE DISCRETION OF THE SERVICE CENTER DIRECTOR IF A SUBSTANTIAL NUMBER OF "Q" RECORDS SHOW A BLANK 1st NAME LINE OR AN INVALID 1st NAME LINE. Left justify and blank fill.
13	174–208	2nd Name Line	Enter supplementary name information of the recipient on this line. Use this line for additional names (e.g. of partners or joint owners), for trade names, stage names, aliases. Use this line also for "care of", "via", or "through" information. Valid characters are the same as in the 1st name line, except for the asterisk(*) which is invalid here, and the percent(%) which is valid in the first position only (as shorthand for "in care of"). If no additional name data is to be provided, blanks are to be inserted. Left justify and blank fill.
14	209–243	3rd Name Line	Enter further name data if applicable; otherwise blank fill. Specifications are precisely as for the 2nd Name Line. See Street Address, below.

NOTE: 105 total characters are available for name information. The Service encourages full identification of nonresident alien persons and organizations because data is furnished to their governments in accordance with tax treaties and exchange of information agreements.

15	244–278	Street Address	Enter the recipient's full street address. Valid characters are the same as in the 2nd Name Line except that the percent is not valid. If the street, building, military installation or other name is too long for the 35-character allotment of this element, use the 3rd Name Line as the 1st Street Address Line, and continue on this line as a 2nd Street Address line. This line may be all blank, but only for legitimate reasons; for example, if the recipient is from a small town or inlet or other place where a town or island name is sufficient to enable mail to be received. left justify and blank fill.

Element	Positions	Title	Description
16	279–303	City	Enter the name of City, Town, Village, Municipality or rural place of residence of the recipient. Valid characters are as in street address. Left justify, and blank fill. For U.S. military installations enter one of the following: APO New York — FPO New York APO San Francisco — FPO San Francisco APO Seattle — FPO Seattle APO Miami — FPO Miami The name of the installation or ship may not be entered here, but should be in the Street Address Line.
17	304–318	Province Name	Enter here the name of the Province, Foreign State (but *not* the U.S. State), County, Shire, District, Region, or other political subdivision. For many countries the province (or other political subunit is an important part of the postal address. For Canada the Province MUST be given here; a Canadian province must be expressed as a two-character code from the Canadian Province Code List below. No other abbreviations may be used, nor may the Canadian Province name be written out in full. If a Province (or other political subunit) is not available, blank fill this element. Valid characters are as in the street address. Left justify, blank fill.

Canadian Provinces and Codes

Province	*Province Code*
Alberta	AB
British Columbia	BC
Labrador	LB
Mainitoba	MB
New Brunswick	NB
Newfoundland	NF
Nova Scotia	NS
Northwest Territories	NT
Ontario	ON
Prince Edward Island	PE
Quebec	PQ
Saskatchewan	SK
Yukon Territories	YK

Element	Positions	Title	Description
18	319–327	Postal Code	Enter the Foreign or U.S. Postal Code (ZIP Code), if available. Withholding Agents should make an effort to obtain postal codes, especially for the following countries: Belgium, Canada, France, Germany, Italy, Spain, Switzerland, Netherlands, and United Kingdom. For U.S. addresses (including all possessions) a ZIP Code must be given. All postal codes should be left justified and blank filled. Alphabetic, numeric, and blank characters only are allowed here. Do not omit any blanks that may appear in the Zip Code.
19	328 & 329	State Code	For all U.S. addresses enter the correct two-letter code as prescribed for Post Office use. The state code *must* be present for all U.S. addresses, including territories and APO/FPO. Leave blank for non-U.S. addresses. See list in Section 4, above.
20	330–349	Country Name	Enter the unabbreviated name of the recipient's country. Omit political titles such as "People's Republic Of",

Element	Positions	Title	Description
			"Kingdom of", etc. Use the English Language name, as opposed to the native language name. For example, use "Finland" and not "Suomi". Leave this field blank for all U.S. addresses, including territories, and APO/FPO. Left justify and blank fill.
21	350 & 351	Income Code	Enter the two digit income code from the following list. Valid range is 01–23. If a given recipient receives more than one kind of income, additional "Q" records must be prepared, since only one income code may be shown per "Q" record.

Income Code List

01	Interest paid by U.S. obligators—general
02	Interest on real property mortgages
03	Interest paid to a controlling foreign corporation
04	Interest paid by foreign corporations (U.S. Agent)
05	Interest in tax-free government bond
06	Dividends paid by U.S. corporation general
07	Dividends paid by U.S. subsidiary to foreign parent corporation
08	Dividends paid by foreign corporations
09	Capital gains
10	Industrial royalties
11	Motion Picture or television copyright royalties
12	Other copyright royalties
13	Real Property income and natural resources royalties
14	Pensions or annuities
15	Scholarship or fellowship compensations
16	Compensations for independent personal services
17	Compensations for dependent personal services
18	Compensations for teaching
19	Compensations during training
20	Other income (non-personal service compensations)
21	Social Security benefits
22	Railroad Retirement (Tier 1) benefits
23	Railroad Retirement (Tier 2) benefits

Element	Positions	Title	Description
22	352 & 353	Type of Recipient Code	Enter two digit code from the list below. Valid range is 01-10.

Code	*Type of Recipient*
01	Individual
02	Corporation
03	Partnership
04	Fiduciary
05	Nominee
06	Government or International Organization
07	"Tax Exempt" Organization
08	Private Foundation
09	Other
10	Type of Recipient unknown

23	354—364	Gross Income Paid	Enter dollars and cents up to 11 characters. Do *not* enter decimal point. Right justify and zero fill. An income amount other than zero must be shown. For whole dollar amounts, the cents *must* be shown by zeros. For example, $1500 should be shown as 00000150000 where the leftmost 5 zeros are "filler" and the rightmost 2 zeros represent cents.
24	365	Exemption Code	Enter the one-digit exemption code from the list below. If

Element	Positions	Title	Description
			the rate of tax shown is 00%, enter the code of 1-4 that applies. If the rate of tax shown is other than 00%, enter a zero in this field. *Code* *Description* Zero No exemption claimed, rate of tax is above 00% 1 Income is effectively connected with a U.S. trade or business (Form 4224 must be attached to Form 1042) 2 Income is exempt from tax by th Internal Revenue Code 3 Income is non-U.S. sourced 4 No withholding per treaty for this type of income
25	366	Correction Indicator	Enter the one position code to identify if this return is the original issuance, an amendment to a previously submitted return, or a total replacement to a previously submitted return. *Code* *Description* Zero Original return R Replacement return A Amended return
26	367 & 368	Rate of Tax	Enter two-digit tax rate. Do not use percent signs or decimal points. A valid rate must be shown. For fractional rates, drop the fraction (e.g. for 12½ use 12, and for 27½ use 27). Valid tax rates are: 00 02 04 05 10 12 14 15 20 25 27 30 Note that when an exemption code of 1-4 is used for element 24, the Rate of Tax *must* be zero.
27	369–379	Amount of Tax Withheld	Enter in dollars and cents the amount of tax withheld, if any. An amount must be shown if the Rate of Tax is greater than 00, or if income is not otherwise exempt from withholding. Specifications are the same as for Element 23 (Gross Income Paid). Right justify and zero fill.
28	380–414	Payer's Name	Enter the name of the Payer of Income, if different from the Withholding Agent, up to the limit of 35 characters Abbreviate as needed, omitting punctuation. Left justify and blank fill. If withholding Agent and payer are one in the same, blank fill Payer Name.
29	415–423	Payer's EIN	Enter the 9 digit Payer's Employer Identification Number if element 28, Payere Name, is significant. Blank fill if unknown or Payer Name is blank.
30	424–450	(Reserved)	Blank Fill.

NOTE: All money fields must be mathematically verified by the transmitter before being sent to the Service.

SEC. 6. WITHHOLDING AGENT "W" RECORD

Enter a "W" record after the last "Q" record submitted for a particular Withholding Agent. The "W" record serves as a summary of the preceding "Q" record data, and enables the Service to double-check the correctness of information received. Several "W" records for different withholding agents may appear on the same Transmitter's file. Also, the "W" record may refer to "Q" records on more than one reel, provided all of the preceding "Q" records are for the same withholding agent. A "W" record may only be followed by new Recipient "Q" records for the next Withholding Agent, if any, or by an End of Transmission "Y" record. The "W" record cannot be followed by a tape mark. Each "W" record has a fixed length of 450 positions. All elements of data in the "W" record are required as follows:

Element	Positions	Title	Description
1	1	Record Type	Enter the letter "W".
2	2 & 3	Payment Year	Enter the last two digits of the calendar year for which income and withholding are being reported. All recipient "Q" records must report payments for this year *only*. Different tax years may not appear on the same file.
3	4–12	EIN	Enter the 9 digits of the Employer Identification Number of the *Withholding Agent*. Omit the hyphen.
4	13–47	Agent Name	Enter the name of the Withholding Agent, up to the limit of 35 characters. Abbreviate as needed, omitting punctuation. Left justify and blank fill.
5	48–82	Agent Address	Enter the street address, P.O. Box, or other location of the withholding agent to a limit of 35 characters. Abbreviate as needed, omitting punctuation. Left justify and blank fill.
6	83–102	City	Enter the city, town, or other locality name up to the limit of 20 characters. Left justify and blank fill.
7	103–104	State	Enter the two-character alphabetic code from the list in Section 4 above.
8	105–113	Zip Code	Enter 9 numeric characters for all U.S. addresses (including territories, possessions, and APO/FPO). For 5 digit zip codes, left justify and zero fill. Zero fill for addresses outside the U.S.
9	114–121	"Q" Record Count	Enter the total number of "Q" records for this withholding agent; that is, the total count of "Q" records following the last "W" record, or if this is the first "W" record on the file, the total number of "Q" records since the "T" record. The presence of a "Z" or "T" record does not interrupt the count, which may therefore include consecutive "Q" records on more than one tape reel.
10	122–134	Total Gross Amount Paid	Enter the sum of all gross amounts paid in all "Q" records, counted in Element 9 above. Zero fill and right justify. Do not "round off" this total, since it is used as a "hash total" check on the "Q" records.
11	135–147	Total Tax Withheld	Enter the sum of all tax withheld amounts from all "Q" records counted in Element 9 above. Right justify, zero fill.
12	148–450	Blank fill	Blank fill up to the total of 450 characters.

SEC. 7 END OF REEL "Z" RECORD

End every reel of a file, except the last reel, with an End of Reel "Z" record. A "Z" record may only appear as the last data record of a reel. If records are blocked, the "Z" record must be the last data record in the last block on the reel, but padding records (all 9's) may follow to fill the block. The "Z" record is identical in format to the "W" record. The "Z" record will replace the "W" record in every case where the "W" record would oridinarily fall last on the reel; that is, when all "Q" records for a particular withholding agent have been completed, and reel-end is reached. The "Z" record may only be preceded immediately by a "Q" record, and may only be followed by Trailer labels, if any. Elements of the "Z" record differ from the same elements of the "W" record as follows: (1) Element 1 Record type, will be "Z" instead of "W"; (2) Element 9, total Number of "Q" records, will include a count of all "Q" records since the last preceding "W" record or "T" record; (3) Elements 10 and 11 will likewise total corresponding amounts on "Q" records since the preceding "W" or "T" record.

SEC. 8 END OF TRANSMISSION "Y" RECORD

End the last reel on a file with an End of Transmission "Y" record. The "Y" record may only be preceded by a "W" record. It may only be followed by a tape mark or tape mark and a Trailer Label, if used. The "Y" record will count the total number of withholding agents in the transmission, and the total number of tape reels in the file. The "Y" record has a fixed length of 450 positions, and all elements listed are required.

Element	Positions	Title	Description
1	1	Record Type	Enter letter "Y"
2	2–4	Withholding Agent Count	Enter the total number of withholding agents on this file. This count will be the same as the total number of "W" records. Right justify and zero fill.
3	5–7	Reel Count	Enter the total number of reels for this transmission. Right justify and zero fill.
4	8–450	Blank fill	Blank fill up to the end of the record.

SEC. 9. EFFECT ON OTHER DOCUMENTS

This Revenue Procedure supersedes Rev. Proc. 85-12, 1985-1 C.B. 500.

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26 CFR 601.204: Changes in methods of accounting.
(Also Part 1, Sections 446, 472; 1.446-1, 1.472-6.)

Rev. Proc. 85-54

SECTION 1. PURPOSE AND SCOPE

The purpose of this revenue procedure is to provide a procedure by which taxpayers that use the last-in, first-out method of accounting for inventory (LIFO) and that issued nonconforming financial statements can automatically discontinue the use of the LIFO inventory method for their first tax year beginning on or after July 18, 1984, because of the enactment of section 95 of the Tax Reform Act of 1984 (the Act).

SEC. 2. BACKGROUND

.01 Section 472(c) of the Internal Revenue Code requires a taxpayer using the LIFO inventory method to use no other procedure in inventorying its goods to ascertain the income, profit, or loss of the first tax year for which the LIFO inventory method is to be used, for the purpose of a report or statement covering such tax year to shareholders, partners, or other proprietors, or to beneficiaries, or for credit purposes. Subsection (e) extends this conformity requirement to subsequent tax years.

.02 In *Insilco Corp. v. Commissioner*, 73 T.C. 589 (1979), *nonacq.*, 1982-1 C.B. 1, *aff'd* No. 2231-77 (2d Cir. 1980), three subsidiaries used the LIFO inventory method to compute their income for their financial reports. The subsidiaries issued these financial reports to their parent company. The parent company, however, reported the subsidiaries' earnings in its consolidated financial statements using a non-LIFO inventory method. The Tax Court held that this situation did not violate the LIFO conformity provisions of section 472(e) of the Code.

.03 Section 95(a) of the Act added a new subsection, (g), to section 472 of the Code. Section 472(g)(1), effective for tax years beginning on or after July 18, 1984, provides that all members of the same group of financially related corporations shall generally be treated as one taxpayer for purposes of section 472(c) and 472(e)(2). Section 472(g)(2) defines the term "group of financially related corporations" as (A) any affiliated group as defined in section 1504 determined by substituting "50 percent" for "80 percent" each place it appears in section 1504(a) and without regard to section 1504(b), and (B) any other group of corporations which consolidate or combine for purposes of financial statements.

.04 The Senate Committee on Finance, 98th Cong., 2d Sess., Deficit Reduction Act of 1984, Explanation of Provisions Approved by the Committee on March 21, 1984, 487 (Comm. Print 1984), expresses an expectation that taxpayers who elect to change from the LIFO method for tax purposes as a result of the enactment of section 472(g) will be allowed by the Service to spread over a period not to exceed four years any adjustments required under section 481 of the Code.

.05 Section 1.472-6 of the Income Tax Regulations provides that if a taxpayer is granted permission by the Commissioner to discontinue the use of the LIFO inventory method of taking inventories, and thereafter to use some other method, or if the taxpayer is required by the Commissioner to discontinue the use of the LIFO inventory method by reason of the taxpayer's failure to conform to the requirements detailed in section 1.472-2 (concerning adoption and use of the LIFO inventory method), the inventory of the specified goods for the first tax year affected by the change and for each tax year thereafter shall be taken:

(a) In conformity with the method used by the taxpayer under section 471 in inventorying goods not included in its LIFO inventory computations; or

(b) If the LIFO inventory method was used by the taxpayer with respect to all of the taxpayer's goods subject to the inventory, then in conformity, with the inventory method used by the taxpayer prior to the taxpayer's adoption of the LIFO inventory method; or

(c) If the taxpayer had not used inventories prior to adoption of the LIFO inventory method and had no goods currently subject to inventory by a method other than the LIFO inventory method, then in conformity with such inventory method as may be selected by the taxpayer and approved by the Commissioner as resulting in a clear reflection of income; or

(d) In any event, in conformity with any inventory method to which the taxpayer may change pursuant to application approved by the Commissioner.

.06 Section 446(e) of the Code and section 1.446-1(e)(2)(i) of the regulations state that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446-1(e)(3)(i) provides that except as otherwise provided in section 1.446-1(e)(3)(ii), in order to secure the Commissioner's consent, the taxpayer must file an application on Form 3115, Application for Change in Accounting Method, with the National Office within 180 days after the beginning of the tax year in which the taxpayer desires to make the change. Section 1.446-1(e)(3)(ii) provides that, notwithstanding section 1.446-1(e)(3)(i), the Commissioner may prescribe administrative procedures, subject to such limi-

tations, terms, and conditions as he deems necessary to obtain his consent, to permit taxpayers to change their accounting methods to an acceptable method consistent with applicable regulations.

.07 Section 481(a) of the Code provides that if a taxpayer's taxable income for any tax year is computed under a method of accounting different from the method used for the preceding tax year, then there shall be taken into account those adjustments which are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted. Section 481(c) provides that in the case of any change described in subsection (a), the taxpayer may, in such manner and subject to such conditions as the Secretary may by regulations prescribe, take the adjustments required by subsection (a)(2) into account in computing the tax for the tax year or years permitted under such regulations.

SEC. 3. APPLICATION

.01 *Consent.* In accordance with section 1.446-1(e)(3)(ii) of the regulations, the 180-day rule is waived, and under section 1.446-1(e)(2)(i) consent is hereby granted to taxpayers to change from the LIFO method of accounting for inventory to another permissible method. This consent is given only to those taxpayers who now choose to discontinue using the LIFO inventory method because of the enactment of section 472(g) of the Code. Such consent is granted for the first tax year beginning on or after July 18, 1984, and the change shall be made in accordance with the provisions of this revenue procedure, including the adjustment under section 481(a) described in section 3.04 below.

.02 *Change in accounting method.* Such a change is a change in method of accounting within the meaning of sections 446 and 481 of the Code. Consent to discontinue the use of the LIFO inventory method and change to another acceptable method of inventory accounting will be granted automatically subject to the requirements of section 1.472-6 of the regulations and the provisions of this revenue procedure.

.03 *Year of change.* Pursuant to the consent granted in section 3.01 above, the taxpayers to whom this revenue procedure applies and who choose to change from the LIFO inventory method of accounting for inventory must make the change on their federal income tax return for their first tax year beginning on or after July 18, 1984.

.04 *Section 481(a) adjustment.* An adjustment is required to prevent amounts of income and deductions from being duplicated or omitted within the meaning of section 481 of the Code and the regulations thereunder when, pursuant to the provisions set forth in this revenue procedure, the change in method of accounting is made. That adjustment, whether positive or negative, is referred to as the "section 481(a) adjustment." It shall be taken into account in computing taxable income and in computing corporate earnings and profits. As to taxable income, the adjustment is taken into account in the manner provided in sections 3.05 and 3.06 below. As to corporate earnings and profits, the adjustment is taken into account in the manner provided in Rev. Proc. 79-47, 1979-2 C.B. 528. The change in method of accounting shall be considered to be a change in method of accounting initiated by the taxpayer.

.05 *Section 481(a) adjustment period.*

(1) The appropriate period for taking into account the section 481(a) adjustment, whether positive or negative, referred to in section 3.04 is to be determined as follows:

(a) When the entire net amount of the section 481(a) adjustment is attributable to the tax year immediately preceding the year of change (first preceding year), the total net adjustment is to be taken into account in computing taxable income for the year of change. The amount attributable to the tax year immediately preceding the year of change is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the same change to an acceptable method had been made in the preceding year.

(b) When subparagraph (a) above does not apply, the taxpayer has continuously used the LIFO inventory method for four tax years or more, and 75 percent or more of the net amount of the section 481(a) adjustment is attributable to the 1-tax-year period, 2-tax-year period, or 3-tax-year period immediately preceding the year of change, the highest percent attributable to the 1-, 2-, or 3-tax-year period will be taken into account ratably over a 3-tax-year period beginning with the year of change. Any remaining balance will be taken into account in the fourth year. An amount attributable to the 1-, 2-, or 3-tax-year period is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the same change to an acceptable method had been made at the beginning of the preceding 1-, 2-, or 3-tax-year period.

(c) In all situations in which subparagraphs (a) and (b) do not apply, the net section 481(a) adjustment is to be taken into account ratably over the number of years (not to exceed four) the taxpayer has continuously used the LIFO inventory method.

(2) In applying section 3.05(1), if a taxpayer's books and records do not contain sufficient information to compute the section 481(a) adjustment attributable to the 1-, 2-, 3-tax-year period immediately preceding the year of change, the taxpayer may reasonably estimate these amounts. The taxpayer must submit the computations upon which the estimates are based with the Form 3115, and sign and attach to the Form 3115 the following statement:

Under penalty of perjury, I hereby certify that:

(a) The books and records of (name of the taxpayer) do not contain sufficient information to permit a computation of the section 481(a) adjustment attributable to the 1-tax-year period, 2-tax-year period, or 3-tax-year period immediately preceding the year of change as required by paragraph 3.05(1) of Rev. Proc. 85-54.

(b) Based on the information that is contained in such records, to the best of my information and belief, the entire amount of the section 481(a) adjustment for the year of change (indicate "is" or "is not," as the case may be) attributable to the tax year immediately preceding the year of change, and 75 percent or more of the section 481(a) adjustment for the year of change (indi-

cate "is" or "is not," as the case may be) attributable to the 1-tax-year period, 2-tax-year period, or 3-tax-year period immediately preceding the year of change.

(3) If, on the last day of the two tax years of the adjustment period, the value of the taxpayer's inventory to which the section 481(a) adjustment relates is reduced by more than 33 1/3 percent of the inventory value at the beginning of the first tax year of the adjustment period and is so reduced by at least such percentage at the end of the following tax year (temporary fluctuations are not controlling; permanent reductions are controlling), the remaining balance of the section 481(a) adjustment must be taken into account in determining taxable income in the year succeeding the year of the reduction. If the value of the inventory does not remain reduced for one year, the reduction is not considered permanent and the provisions of this paragraph to not apply.

.06 *Ceasing to engage in the trade or business.* If, at any time prior to the expiration of the adjustment period (as defined in sections 3.05 and 3.06 above), a taxpayer ceases to engage in the trade or business to which the section 481(a) adjustment (as defined in section 3.04 above) relates, the taxpayer shall take into account in the year of such cessation the balance of the adjustment that was not previously taken into account in computing taxable income. See Rev. Rul. 80-39, 1980-1 C.B. 112, which holds that, if a division of a corporation for which a change in method of accounting had been granted ceases to operate the trade or business for which the change in method was granted, the remaining section 481(a) adjustment applicable to the business conducted by that division of the corporation must be taken into account in the year the corporation ceases to engage in that trade or business. For purposes of this condition, the taxpayer is not considered to have ceased the trade or business if the cessation is the result of a transaction to which section 381 of the Code applies. In that case, however, the acquiring corporation shall continue to be subject to this revenue procedure as though it were the acquired corporation.

SEC. 4. RECORDS

.01 Taxpayers must maintain adequate records so that the Internal Revenue Service may, upon examination, verify the data concerning the change in method of accounting.

.02 Taxpayers must keep their books and records for the year of change and for later tax years on the acceptable method that they have chosen and must use this method for all shareholder reports, financial statements, and statements for credit purposes.

SEC. 5. COMPLIANCE WITH CONDITIONS

Taxpayers making a change from the LIFO inventory method to an acceptable method without complying with all the conditions of this revenue procedure will be deemed to have made the change without obtaining the consent of the Commissioner.

SEC. 6. MANNER OF EFFECTING CHANGE

.01 Taxpayers to which this revenue procedure applies must effect the change in their methods of accounting for their first tax year beginning on or after July 18, 1984. The change is effected pursuant to the provisions set forth in this revenue procedure by filing a current Form 3115, in duplicate. The original of the Form 3115 shall be attached to the taxpayer's timely filed federal income tax return for such year (determined with regard to extensions) or to an amended return for such year filed no later than the extended time period prescribed in section 6081 of the Code and the regulations thereunder. Solely for this purpose, a federal income tax return which is filed late, but within the time period described in section 6081 of the Code and the regulations thereunder, shall be treated as timely, regardless of the fact that the taxpayer has not been granted an extension of time for filing its income tax return. At the time the original of the Form 3115 is filed with the federal income tax return, a copy of the Form 3115 shall be filed with the National Office, addressed to the Commissioner of Internal Revenue Attention: CC:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. In addition to the information required on Form 3115, the taxpayer must provide (1) a computation of the section 481(a) adjustment and (2) the period over which the section 481(a) adjustment will be taken into account and the basis for such conclusion. This additional information must accompany both the original Form 3115 and the required copy of Form 3115. The National Office will sample the Forms 3115 to determine whether the requirements of this revenue procedure have been followed.

.02 In order to assist in the processing of these changes in method of accounting and to ensure proper handling, reference to this revenue procedure shall be made a part of the Form 3115 by either typing or legibly printing the following statement at the top of page 1 of Form 3115: "FILED UNDER REV. PROC. 85-54.

.03 Taxpayers who apply the provisions of this revenue procedure to change their methods of accounting must attach and sign (or have signed by an officer who has personal knowledge of the facts) the following statement to the Form 3115:

Under penalty of perjury, I hereby certify that:

(name of taxpayer) is discontinuing the use of LIFO because of the provisions of section 472(g) of the Code.

.04 Taxpayers requesting to discontinue LIFO for reasons other than section 472(g) of the Code must timely file a Form 3115 with the National Office pursuant to section 1.446-1(e)(3)(i) of the regulations. See Rev.Proc. 84-74, 1984-2 C.B. 736. Such taxpayers must also attach a statement to their Form 3115 that under penalties of perjury they did not issue nonconforming financial statements as a result of the operation of section 472(g) of the Code.

SEC. 7. MISCELLANEOUS

.01 Where a taxpayer's change in method of accounting falls within the scope set forth in section 1 of this revenue procedure, the taxpayer must use this revenue procedure to effectuate such change in method of accounting and may not use the provisions of Rev. Proc. 84-74. Thus, the original of the application for permission to change the method of accounting described in this revenue procedure, if filed with the National Office under the general pro-

visions of Rev. Proc. 84-74, will not be considered a valid application. Any such original applications filed by taxpayers with the National Office prior to or after November 18, 1985 (the date of publication of this revenue procedure) will not be processed and these taxpayers will be notified by the National Office to comply with this revenue procedure.

.02 The taxpayer may not elect the LIFO inventory method of accounting for a period of at least 10 tax years beginning with the year of change, unless consent is granted by the Commissioner to change its method of accounting at an earlier time based on a showing of extraordinary circumstances.

.03 The taxpayer shall value its inventory at the beginning and the end of the year of change and for later tax years under the method granted herein unless it obtains permission to change to another recognized method, including the LIFO inventory method (see section 1.446-1 of the regulations and section 7.02 above).

.04 For purposes of section 312 of the Code, the computation of earnings and profits available for the payment of dividends shall follow the new method of accounting and the taxpayer shall take the section 481(a) adjustment into account over the same period as it does for purposes of computing taxable income.

SEC. 8. CHANGE FROM LIFO INVENTORY METHOD NOT MADE UNDER THIS REVENUE PROCEDURE

Taxpayers who use the LIFO inventory method and issued nonconforming financial statements in violation of section 472(g) of the Code for tax years subsequent to their first tax year beginning on or after July 18, 1984, must request permission to change from the LIFO inventory method by filing an application (Form 3115) with the Commissioner in accordance with the requirements of section 1.446-1(e)(3) of the regulations and Rev. Proc. 84-74. Such taxpayers will receive an adjustment period not to exceed two tax years.

SEC. 9. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention CC:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

SEC. 10. EFFECTIVE DATE

This revenue procedure is effective November 18, 1985, the date of its publication in the Internal Revenue Bulletin.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 1, 63, 151, 6012, 6013; 1.1-1, 1.63-1, 1.151-4, 1.6012-1, 1.6013-2.)

Rev. Proc. 85-55

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide the income tax cost-of-living adjustment (indexing) factor as determined pursuant to section 1(f)(3) of the Internal Revenue Code for taxable years beginning in 1986. It also sets forth the application of the factor to the tax tables, the zero bracket amount, the personal exemption amount, and the tax return exemption amount.

SEC. 2. BACKGROUND

Section 104 of the Economic Recovery Tax Act of 1981, 1981-2 C.B. 256, 267-68, instituted, for taxable years beginning after December 31, 1984, adjustments to prevent inflation-caused income tax increases. It provides that the tax tables, the zero bracket amount, the personal exemption amount, and the tax return exemption amount are to be adjusted (indexed) each calendar year by a cost-of-living factor determined under a prescribed method. Rev. Proc. 84-79, 1984-2 C.B. 755, sets forth the adjustments for taxable years beginning in 1985.

SEC. 3. COST-OF-LIVING ADJUSTMENT FACTOR

Based on the method prescribed in section 1(f) of the Code, the cost-of-living adjustment factor for taxable years beginning in 1986 has been determined to be 7.9112588 percent, the percentage by which the average CPI for the 12 months ending in September 1985 (319.4083333) exceeds the average CPI for the 12 months ending in September 1983 (295.9916667). The adjustment factor is applied to the amounts that were in effect for taxable years beginning in 1984.

SEC. 4. APPLICATION OF FACTOR TO SECTIONS 1, 63, 151, 6012, AND 6013 OF THE CODE

.01 The following adjusted tax tables are prescribed in lieu of the tables contained in paragraph (3) of subsections (a), (b), (c), (d), and (e) of section 1 of the Code with respect to taxable years beginning in 1986:

TABLE 1—Section 1(a)(3).—Married Individuals Filing Joint Returns and Surviving Spouses:

If taxable income is:	The tax is:
Not over 3,670	No tax.
Over $ 3,670 but not over $ 5,940	11% of the excess over $ 3,670
Over $ 5,940 but not over $ 8,200	$ 249.70 plus 12% of the excess over $ 5,940
Over $ 8,200 but not over $ 12,840	$ 520.90 plus 14% of the excess over $ 8,200
Over $ 12,840 but not over $ 17,270	$ 1,170.50 plus 16% of the excess over $ 12,840
Over $ 17,270 but not over $ 21,800	$ 1,879.30 plus 18% of the excess over $ 17,270
Over $ 21,800 but not over $ 26,550	$ 2,694.70 plus 22% of the excess over $ 21,800
Over $ 26,550 but not over $ 32,270	$ 3,739.70 plus 25% of the excess over $ 26,550
Over $ 32,270 but not over $ 37,980	$ 5,169.70 plus 28% of the excess over $ 32,270
Over $ 37,980 but not over $ 49,420	$ 6,768.50 plus 33% of the excess over $ 37,980

TABLE 1—Section 1(a)(3).—Married Individuals Filing Joint Returns and Surviving Spouses:—Continued

If taxable income is:	The tax is:
Over $ 49,420 but not over $ 64,750	$10,543.70 plus 38% of the excess over $ 49,420
Over $ 64,750 but not over $ 92,370	$16,369.10 plus 42% of the excess over $ 64,750
Over $ 92,370 but not over $118,050	$27,969.50 plus 45% of the excess over $ 92,370
Over $118,050 but not over $175,250	$39,525.50 plus 49% of the excess over $118,050
Over $175,250	$67,553.50 plus 50% of the excess over $175,250

TABLE 2—Section 1(b)(3).—Heads of Households.—

If taxable income is:	The tax is:
Not over $2,480	No tax.
Over $ 2,480 but not over $ 4,750	11% of the excess over $ 2,480
Over $ 4,750 but not over $ 7,010	$ 249.70 plus 12% of the excess over $ 4,750
Over $ 7,010 but not over $ 9,390	$ 520.90 plus 14% of the excess over $ 7,010
Over $ 9,390 but not over $ 12,730	$ 854.10 plus 17% of the excess over $ 9,390
Over $ 12,730 but not over $ 16,190	$ 1,421.90 plus 18% of the excess over $ 12,730
Over $ 16,190 but not over $ 19,640	$ 2,044.70 plus 20% of the excess over $ 16,190
Over $ 19,640 but not over $ 25,360	$ 2,734.70 plus 24% of the excess over $ 19,640
Over $ 25,360 but not over $ 31,080	$ 4,107.50 plus 28% of the excess over $ 25,360
Over $ 31,080 but not over $ 36,800	$ 5,709.10 plus 32% of the excess over $ 31,080
Over $ 36,800 but not over $ 48,240	$ 7,539.50 plus 35% of the excess over $ 36,800
Over $ 48,240 but not over $ 65,390	**$11,543.50 plus 42% of the excess over $ 48,240**
Over $ 65,390 but not over $ 88,270	$18,746.50 plus 45% of the excess over $ 65,390
Over $ 88,270 but not over $116,870	$29,042.50 plus 48% of the excess over $ 88,270
Over $116,870	$42,770.50 plus 50% of the excess over $116,870

TABLE 3—Section 1(c)(3).—Unmarried Individuals (Other Than Surviving Spouses and Heads of Households).—

If taxable income is:	The tax is:
Not over $ 2,480	No tax.
Over $ 2,480 but not over $ 3,670	11% of the excess over $ 2,480
Over $ 3,670 but not over $ 4,750	$ 130.90 plus 12% of the excess over $ 3,670
Over $ 4,750 but not over $ 7,010	$ 260.50 plus 14% of the excess over $ 4,750
Over $ 7,010 but not over $ 9,170	$ 576.90 plus 15% of the excess over $ 7,010
Over $ 9,170 but not over $11,650	$ 900.90 plus 16% of the excess over $ 9,170
Over $11,650 but not over $13,920	$ 1,297.70 plus 18% of the excess over $11,650
Over $13,920 but not over $16,190	$ 1,706.30 plus 20% of the excess over $13,920
Over $16,190 but not over $19,640	$ 2,160.30 plus 23% of the excess over $16,190
Over $19,640 but not over $25,360	$ 2,953.80 plus 26% of the excess over $19,640
Over $25,360 but not over $31,080	$ 4,441.00 plus 30% of the excess over $25,360
Over $31,080 but not over $36,800	$ 6,157.00 plus 34% of the excess over $31,080
Over $36,800 but not over $44,780	$ 8,101.80 plus 38% of the excess over $36,800
Over $44,780 but not over $59,670	$11,134.20 plus 42% of the excess over $44,780
Over $59,670 but not over $88,270	$17,388.00 plus 48% of the excess over $59,670
Over $88,270	$31,116.00 plus 50% of the excess over $88,270

TABLE 4—Section 1(d)(3).—Married Individuals Filing Separate Returns.—

If taxable income is:	The tax is:
Not over $ 1,835	No tax.
Over $ 1,835 but not over $ 2,970	11% of the excess over $ 1,835
Over $ 2,970 but not over $ 4,100	$ 124.85 plus 12% of the excess over $ 2,970
Over $ 4,100 but not over $ 6,420	$ 260.45 plus 14% of the excess over $ 4,100

TABLE 4—Section 1(d)(3).—Married Individuals Filing Separate Returns—Continued

If taxable income is:	No. tax.	The tax is:
Over $ 6,420 but not over $ 8,635	$	585.25 plus 16% of the excess over $ 6,420
Over $ 8,635 but not over $10,900	$	939.65 plus 18% of the excess over $ 8,635
Over $10,900 but not over $13,275	$	1,347.35 plus 22% of the excess over $10,900
Over $13,275 but not over $16,135	$	1,869.85 plus 25% of the excess over $13,275
Over $16,135 but not over $18,990	$	2,584.85 plus 28% of the excess over $16,135
Over $18,990 but not over $24,710	$	3,384.25 plus 33% of the excess over $18,990
Over $24,710 but not over $32,375	$	5,271.85 plus 38% of the excess over $24,710
Over $32,375 but not over $46,185	$	8,184.55 plus 42% of the excess over $32,375
Over $46,185 but not over $59,025	$	13,984.75 plus 45% of the excess over $46,185
Over $59,025 but not over $87,625	$	19,762.75 plus 49% of the excess over $59,025
Over $87,625	$	33,776.75 plus 50% of the excess over $87,625

TABLE 5—Section 1(e)(3).—Estates and Trusts.—

If taxable income is:	The tax is:
Not over $ 1,135	11% of taxable income.
Over $ 1,135 but not over $ 2,265	$ 124.85 plus 12% of the excess over $ 1,135
Over $ 2,265 but not over $ 4,585	$ 260.45 plus 14% of the excess over $ 2,265
Over $ 4,585 but not over $ 6,800	$ 585.25 plus 16% of the excess over $ 4,585
Over $ 6,800 but not over $ 9,065	$ 939.65 plus 18% of the excess over $ 6,800
Over $ 9,065 but not over $11,440	$ 1,347.35 plus 22% of the excess over $ 9,065
Over $11,440 but not over $14,300	$ 1,869.85 plus 25% of the excess over $11,440
Over $14,300 but not over $17,160	$ 2,584.85 plus 28% of the excess over $14,300
Over $17,160 but not over $22,875	$ 3,385.65 plus 33% of the excess over $17,160
Over $22,875 but not over $30,540	$ 5,271.60 plus 38% of the excess over $22,875
Over $30,540 but not over $44,350	$ 8,184.30 plus 42% of the excess over $30,540
Over $44,350 but not over $57,195	**$13,984.50 plus 45% of the excess over $44,350**
Over $57,195 but not over $85,790	$19,764.75 plus 49% of the excess over $57,195
Over $85,790	$33,776.30 plus 50% of the excess over $85,790

.02 The following adjusted "zero bracket amounts" are set forth for purposes of section 63(d)(1) of the Code:

If the applicable tax table is:	The amount is:
Table 1	$3,670
Table 2	$2,480
Table 3	$2,480
Table 4	$1,835

.03 For purposes of the personal "exemption amount" under section 151(f) of the Code, the adjusted amount is $1,080.

.04 The following adjusted amounts are set forth for purposes of section 6012 of the Code:

1. The section 6012(a)(1)(D)(i) "zero bracket amount" is $2,480 for section 6012(a)(1)(A)(i) and $3,670 for sections 6012(a)(1)(A)(ii) and (iii).

2. The section 6012(a)(1)(D)(ii) "exemption amount" is $1,080.

3. The section 6012(a)(1)(A)(i) "sum of the exemption amount plus the zero bracket amount" is $3,560 ($1,080 + $2,480).

4. The section 6012(a)(1)(A)(ii) "sum of the exemption amount plus the zero bracket amount" is $4,750 ($1,080 + $3,670).

5. The section 6012(a)(1)(A)(iii) "sum of twice the exemption amount plus the zero bracket amount" is $5,830 ((2 × $1,080) + $3,670).

.05 For purposes of section 6013(b)(3) of the Code, the adjusted "exemption amount" is $1,080.

SEC. 5. EFFECTIVE DATE

This revenue procedure is effective January 1, 1986, for any taxable year beginning in 1986.

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26 CFR 601.702: Publication and public inspection.

Rev. Proc. 85-56

SECTION 1. BACKGROUND

Rev. Proc. 66-3, 1966-1 C.B. 601, sets forth procedures to be followed by District Directors of the Internal Revenue Service in permitting inspection of federal tax returns and related documents filed under the Internal Revenue Code, and in furnishing copies of such returns and documents. Section 15 of Rev. Proc. 66-3 is entitled "Charges for Copies of Returns and Related Documents". Rev. Proc. 84-71, 1984-2 C.B. 735, modified Rev. Proc. 66-3 by substituting a new Section 15, effective October 1, 1983. Section 15.01, as modified by Rev. Proc. 84-71, imposes a $5.00 charge for each request of a copy of a return or other document (other than Employee Plans and Exempt Organizations Returns). Section 15.02, as modified, imposes a $2.50 charge for each request for a transcript of individual income tax account information. Section 15.03, as modified, imposes a charge of $1.00 for the first

page and $.10 for each subsequent page for copies of Employee Plans and Exempt Organizations tax returns and related documents. Section 15.04, as modified, imposes a $2.50 charge for each Form 1040A and 1040EZ verification.

SEC. 2. PURPOSE

The purpose of this revenue procedure is to further modify Rev. Proc. 66-3.

SEC. 3. PROCEDURE

Rev. Proc. 66-3 is modified to reflect a $4.25 charge in section 15.01, a $2.25 charge in section 15.02 and a charge of $.15 "for each subsequent page" in section 15.03. Section 15.04 is deleted, thereby eliminating a separate charge for verification of Forms 1040A or 1040EZ. Verification of those forms may now be secured through a request for tax account information under section 15.02 of this revenue procedure. The revised section 15 shall read:

SEC. 15. CHARGES FOR COPIES OF RETURNS, RELATED DOCUMENTS, AND RETURN INFORMATION

Charges for furnishing copies of returns, related documents, and return information will be as follows:

.01 A charge of $4.25 will be made for each request of a copy or other related document (other than Employee Plans and Exempt Organization Returns). Payments will be submitted in advance using Internal Revenue Service Form 4506, Request for copy of Tax Form or Individual Income Tax Account Information.

.02 A charge of $2.25 will be made for each request for a transcript of individual income tax account information. Payments will be submitted according to procedures prescribed in .01 (above).

.03 A charge of $1.00 for the first page and $.15 for each subsequent page will be made for copies of Employee Plans and Exempt organizations tax returns and related documents. Payments will be submitted subsequent to receipt of Form 2860, Document Transmittal and Bill.

SEC. 4. EFFECTIVE DATE

This revenue procedure is effective October 1, 1985.

SEC. 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 66-3, as modified by Rev. Proc. 84-71, is further modified, effective October 1, 1985.

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26 CFR 601.201: Rulings and determination letters

Rev. Proc. 85-57

SECTION 1. PURPOSE

The purpose of this revenue procedure is to amplify section 9 of Rev. Proc. 85-1, 1985-1 C.B. 440 (Instructions to Taxpayer), to assure receipt of complete and adequate information and expedite the processing of requests for rulings from public utility taxpayers on the normalization requirements provided by sections 46(f), 167(l), and 168(e)(3) of the Internal Revenue Code.

SEC. 2. BACKGROUND

Section 9 of Rev. Proc. 85-1 provides instructions to taxpayers requesting rulings from the Internal Revenue Service. Although the request for ruling on normalization matters is submitted by the public utility taxpayer, the proposed change is frequently initiated by the regulatory commission that has ratemaking authority for the taxpayer. Input by the regulatory commission will aid in making the ruling responsive to the needs of both the taxpayer and the regulatory commission.

SEC. 3. SCOPE AND OBJECTIVE

A ruling request that involves a question of whether a rate order, proposed or issued by a regulatory agency, will meet the normalization requirements of sections 46(f), 167(l), and 168(e)(3) of the Code, ordinarily will not be considered unless the taxpayer states in the request for ruling whether:

(1) the regulatory authority responsible for establishing or approving the taxpayer's rates has reviewed the request and believes that the request is adequate and complete, and

(2) the taxpayer will permit the regulatory authority to participate in any National Office conference concerning the request.

SEC. 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 85-1 is amplified.

SEC. 5. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests submitted to the National Office after December 18, 1985.

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26 CFR 601.204: Changes in accounting periods and methods of accounting.
(Also Part I, Section 442; 1.442-1.)

Rev. Proc. 85-58

SECTION 1. PURPOSE

The purpose of this revenue procedure is to modify and supersede Rev. Proc. 76-9, 1976-1 C.B. 547, and Rev. Proc. 79-2, 1979-1 C.B. 482, by simplifying the procedure to be followed by certain organizations exempt under section 501(a) of the Internal Revenue Code desiring to change their annual accounting periods.

SEC. 2. BACKGROUND

Rev. Proc. 76-9, as modified by Rev. Proc. 79-2, provides an administrative procedure whereby certain organizations exempt from federal income tax may expeditiously obtain approval of a change in accounting period.

SEC. 3. PROCEDURE

.01. Except as provided in section 3.03 below, organizations desiring to change their annual accounting periods (including organizations that come within the exception contained in section 1.442-1(c) of the Income Tax Regulations under which prior approval of the Commissioner to change is not required) may effect the change by timely filing the applicable information return, Form 990 (Return of Organization Exempt from Income Tax), Form 990-PF (Return of Private Foundation), Form 990-BL (Information and Initial Excise Tax Return for Black Lung Benefit Trusts and Certain Related Persons), or Form 1065 (U.S. Partnership Return of Income), with the appropriate Internal Revenue Service Center for the short period for which a return is required. The Form should indicate that a change of accounting period is being made.

.02. Annual information returns, Forms 990, 990-PF, and 990-BL, must

be filed by the fifteenth day of the fifth month following the close of the short period. If an organization is not required to file an annual information return, but files a Form 990-T (Exempt Organization Business Income Tax Return), it may change its annual accounting period by timely filing the Form 990-T with the appropriate Service Center. If neither an information return nor a Form 990-T is required to be filed, it is not necessary to otherwise notify the Service that a change of accounting period is being made, except as provided in section 3.03. Applicants complying with this revenue procedure will be deemed to have obtained the approval of the Commissioner of Internal Revenue for a change in accounting period.

.03. If an organization has previously changed its annual accounting period at any time within the ten calendar years ending with the calendar year that includes the beginning of the short period resulting from the change of an annual accounting period, and if it had a filing requirement at any time during that ten year period, it must file a Form 1128 (Application for Change in Accounting Period) with the appropriate Internal Revenue Service Center with its timely-filed annual information return or Form 990-T, as appropriate, whether or not the filing of the information return or Form 990-T would have otherwise been required for that year. The Form 1128 must be filed by the fifteenth day of the fifth month following the close of the short period.

SEC. 4. EXEMPT ORGANIZATIONS NOT COVERED BY SECTION 3

01. The procedures described in section 3 above do not apply to farmers' cooperatives exempt from federal income tax under section 521 of the Code, or to organizations described in sections 526, 527, or 528. These organizations file their applications on Form 1128 for a change in their annual accounting periods with the Commissioner of Internal Revenue, Attn: CC:C:C, Washington, D.C. 20224.

02. This revenue procedure does not apply to organizations described in section 401(a) of the Code. In accordance with Rev. Proc. 77-44, 1977-2 C.B. 578, as modified by Announcement 79-43, 1979-12 I.R.B. 25, these organizations must file applications on Form 5308, Request for Change in Plan/Trust Year, with the Commissioner of Internal Revenue, Attn: OP:E:EP, Washington, D.C. 20224.

SEC. 5. RECORDS

The books of the organization must be closed as of the last day of the last month of the new tax year. Returns for subsequent years must be made on the basis of a full 12 months ending on the last day of the last month of the new tax year.

SEC. 6. LATE APPLICATIONS FOR CHANGE IN ACCOUNTING PERIOD

Organizations described in section 3.03 that did not file a Form 1128 with a timely-filed annual information return or a timely-filed Form 990-T for the short period may request relief under section 1.9100-1 of the regulations. (See section 1.9100-1(a)(3) of the regulations and section 2 of Rev. Proc. 79-63, 1979-2 C.B. 578.)

SEC. 7. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 76-9 and Rev. Proc. 79-2 are modified and as modified are superseded. If any revenue procedure or revenue ruling makes reference to Rev. Proc. 76-9 or Rev. Proc. 79-2, the reference to this revenue procedure should be appropriately substituted. For the administrative procedures to be followed in requesting a change in accounting period of certain exempt organizations on a group basis, see Rev. Proc. 76-10, 1976-1 C.B. 548, and Rev. Proc. 79-3, 1979-1 C.B. 483.

SEC. 8. EFFECTIVE DATE

This revenue procedure shall be effective for a change in accounting period where the last day of the short period ends on or after December 31, 1985.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 85-59

SECTION 1. BACKGROUND

Rev. Proc. 85-22, 1985-1 C.B. 550, sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue Service. Section 3 of Rev. Proc. 85-22 is entitled "Areas In Which Rulings Or Determination Letters Will Not Be Issued."

SEC. 2. PROCEDURE

Rev. Proc. 85-22 is hereby amplified by adding to section 3.01 the following two new sections:

(1) Section 871(g)(1)(B).—Original Issue Discount Obligations.—Whether a debt instrument having original issue discount within the meaning of section 1273 is not an original issue discount obligation within the meaning of section 871(g)(1)(B)(i) when the instrument is payable 183 days or less from the date of original issue (without regard to the period held by the taxpayer) and such debt instrument is issued by a domestic corporation and is purchased by its controlled foreign corporation.

(2) Section 956(b)(1)(C).—United States Property Defined.—Whether an indebtedness is excludable from the definition of the term "obligation" under section 1.956-2(d)(2)(ii) of the regulations because the indebtedness is collected within one year from the time it is incurred or matures within one year from the time it is incurred but is not collected within such period solely by reason of the inability or unwillingness of the debtor to make payment within such period.

SEC. 3. PURPOSE

These two sections are being added to Rev. Proc. 85-22 because, to the extent the answers to the issues are not clear as a matter of law, they are too dependent on subsequent facts for the Service to determine in advance the substance of the transactions.

SEC. 4. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests on hand in the National Office on December 16, 1985, the date of publication of this revenue procedure in the Internal Revenue Bulletin, as well as to requests received thereafter.

SEC. 5. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 85-22 is amplified.

Social Security Contribution and Benefit Base

Under authority contained in the Social Security Act, the Secretary, De-

partment of Health and Human Services, has determined and announced (50 F.R. 45558, dated October 31, 1985) that the contribution and benefit base for remuneration paid in 1986 and self-employment income earned in taxable years beginning in 1986 is $42,000.

Treasury Department Circular No. 230 (Revised 9–85)

Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries before the Internal Revenue Service

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AUTHORITY: Sec. 3,23 Stat. 258, secs. 2-12,60 Stat.237 et seq: 5 U.S.C. 301, 500, 551-559, 31 U.S.C. 1026; Reorg. Plan No. 26 of 1950, 15 F.R. 4935,65 Stat. 1280,3 CFR, 1949-1953 Comp., except as otherwise noted.

SOURCE: Department Circular 230, Revised 31 F.R. 10773, Aug. 13, 1966, unless otherwise noted.

§ 10.0 Scope of part.

This part contains rules governing the recognition of attorneys, certified public accountants, enrolled agents, and other persons representing clients before the Internal Revenue Service. Subpart A of this part sets forth rules relating to authority to practice before the Internal Revenue Service; Subpart B of this part prescribes the duties and restrictions relating to such practice; Subpart C of this part contains rules relating to disciplinary proceedings; and Subpart D of this part contains general provisions, including provisions relating to availability of official records.

[42 F.R. 38352, July 28, 1977]

Subpart A-Rules Governing Authority To Practice

§ 10.1 Director of practice.

(a) *Establishment of office.* There is established in the Office of the Secretary of the Treasury the office of Director of Practice. The Director of Practice shall be appointed by the Secretary of the Treasury.

(b) *Duties.* The Director of Practice shall act upon appeals from decisions of the Commissioner of Internal Revenue denying applications for enrollment to practice before the Internal Revenue Service; institute and provide for the conduct of disciplinary proceedings relating to attorneys, certified public accountants, and enrolled agents; make inquiries with respect to matters under his jurisdiction; and perform such other duties as are necessary or appropriate to carry out his functions under this part or as are prescribed by the Secretary of the Treasury.

(c) *Acting Director.* The Secretary of the Treasury will designate an officer or employee of the Treasury Department to act as Director of Practice in the event of the absence of the director or of a vacancy in that office.

§ 10.2 Definitions.

As used in this part, except where the context clearly indicates otherwise, the term:

(a) "Practice before the Internal Revenue Service" comprehends all matters connected

with presentation to the Internal Revenue Service or any of its officers or employees relating to a client's rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include the preparation and filing of necessary documents, correspondence with and communications to the Internal Revenue Service, and the representation of a client at conferences, hearings, and meetings.

(b) "Attorney" means any person who is a member in good standing of the bar of the highest court of any State, possession, territory, Commonwealth, or the District of Columbia.

(c) "Certified public accountant" means any person who is duly qualified to practice as a certified public accountant in any State, possession, territory, Commonwealth, or the Distric of Columbia.

(d) "Commissioner" refers to the Commissioner of Internal Revenue.

[3] F.R. 10773, Aug. 13, 1966, as amended at 37 F.R. 1017, Jan. 21, 1972; 42 F.R. 38352, July 28, 1977; 49 F.R. 6719, Feb. 23, 1984]

§ 10.3 Who may practice.

(a) *Attorneys.* Any attorney who is not currently under suspension or disbarment from practice before the Internal Revenue Service may practice before the Service upon filing with the Service a written declaration that he is currently qualified as an attorney and is authorized to represent the particular party on whose behalf he acts. An enrollment card issued to such person before the effective date of this regulation shall be invalid and may not be used in lieu of such written declaration.[1]

(b) *Certified public accountants.* Any certified public accountant who is not currently under suspension or disbarment from practice before the Internal Revenue Service may practice before the Service upon filing with the Service a written declaration that he is currently qualified as a certified public accountant and is authorized to represent the particular party on whose behalf he acts. An enrollment card issued to such person before the effective date of this regulation shall be invalid and may not be used in lieu of such written declaration.[1]

(c) *Enrolled agents.* Any person enrolled as an agent pursuant to this part may practice before the Internal Revenue Service.

(d) *Enrolled Actuaries.* (1) Any individual who is enrolled as an actuary by the Joint Board for the Enrollment of Actuaries pursuant to 29 U.S.C. 1242 may practice before the Internal Revenue Service upon filing with the Service a written declaration that he/she is currently qualified as an enrolled actuary and is authorized to represent the particular party on whose behalf he/she acts. Practice as an enrolled actuary is limited to representation with respect to issues involving the following statutory provisions.

Internal Revenue Code (Title 26 U.S.C.) sections: 401 (qualification of employee plans), 403(a) (relating to whether an annuity plan meets the requirements of section 404(a) (2), 404 (deductibility of employer contributions, 405 (qualification of bond purchase plans), 412 (funding requirements for certain employee plans), 413 (application of qualification requirements to collectively bargained plans and to plans maintained by more than one employer), 414 (containing definitions and special rules relating to the employee plan area), 4971 (relating to excise taxes payable as a result of an accumulated funding deficiency under section 412). 6057 (annual registration of plans) 6058 (information required in connection with certain plans of deferred compensation), 6059 (periodic report of actuary), 6652(e) (failure to file annual registration and other notifications by pension plan), 6652(f) (failure to file information required in connection with certain plans of deferred compensation), 6692 (failure to file actuarial report), 7805(b) (relating to the extent, if any, to which an Internal Revenue Service ruling or determination letter coming under the herein listed statutory provisions shall be applied without retroactive effect); and 29 U.S.C. 1083 (relating to waiver of funding for nonqualified plans).

(2) An individual who practices before the Internal Revenue Service pursuant to this subsection shall be subject to the provisions of this part in the same manner as attorneys, certified public accountants and enrolled agents.

(e) *Others.* Any person qualifying under § 10.7 or § 10.5(c) may practice before Internal Revenue Service.

(f) *Government officers and employees; others.* No officer or employee of the United States in the executive, legislative, or judicial branch of the Government, or in any agency of the United States, including the District of Columbia, may practice before the Service, except that such officer or employee may, subject to the conditions and requirements of these regulations and of 18 U.S.C. 205, represent a member of his immediate family or any other person or estate for which he serves as guardian, executor, administrator, trustee, or other personal fiduciary. No Member of Congress or Resident Commissioner (elect or serving) may practice before the Service in connection with any matter for which he directly or indirectly receives, agrees to receive, or seeks any compensation. 18 U.S.C. 203, 205. Nothing herein shall be construed as prohibiting an officer or employee of the United States as a foresaid, who is otherwise eligible to practice under the provision of this part, from representing others before the Internal Revenue Service when doing so in the proper discharge of his official duties.

(g) *State officers and employees.* No officer or employee of any State, or subdivision thereof, whose duties require him to pass upon, investigate, or deal with tax matters of such State or subdivision, may practice before the Service, if

such State employment may disclose facts or information applicable to Federal tax matters.

[3] F.R. 10773, Aug. 13, 1966, as amended at 35 F.R. 13205, Aug. 19, 1970; 36 F.R. 8671, May 11, 1971; 44 F.R. 4944, Jan. 24, 1979]

§ 10.4 Eligibility for enrollment.

(a) *Enrollment upon examination.* The Commissioner may grant enrollment to an applicant who demonstrates special competence in tax matters by written examination administered by the Internal Revenue Service and who has not engaged in any conduct which would justify the suspension or disbarment of any attorney, certified public accountant, or enrolled agent under the provisions of this part.

(b) *Enrollment of former Internal Revenue Service employees.* The Commissioner may grant enrollment to an applicant who has not engaged in any conduct which would justify the suspension or disbarment of any attorney, certified public accountant, or enrolled agent under the provisions of this part and who, by virtue of his past service and technical experience in the Internal Revenue Service has qualified for such enrollment, as follows:

(1) Application for enrollment on account of former employment in the Internal Revenue Service shall be made to the Commissioner. Each applicant will be supplied a form by the Commissioner which shall indicate the information required respecting the applicant's qualifications. In addition to the applicant's name, address, educational experience, etc., such information shall specifically include a detailed account of the applicant's employment in the Internal Revenue Service, which account shall show (i) positions held, (ii) date of each appointment and termination thereof, (iii) nature of services rendered in each position, with particular reference to the degree of technical experience involved, and (iv) name of supervisor in such positions, together with such other information regarding the experience and training of the applicant as may be relevant.

(2) Upon receipt of each such application, it shall be transmitted to the appropriate officer of the Internal Revenue Service with the request that a detailed report of the nature and rating of the applicant's services in the Internal Revenue Service, accompanied by the recommendation of the superior officer in the particular unit or division of the Internal Revenue Service that such employment does or does not qualify the applicant technically or otherwise for the desired authorization, be furnished to the Commissioner.

(3) In examining the qualification of an applicant for enrollment on account of employment in the Internal Revenue Service, the Commissioner will be governed by the following policies:

(i) Enrollment on account of such employment may be of unlimited scope or may be limited to permit the presentation of matters only of the particular class or only before the particular unit or division of the Internal Revenue Service for which his former employment in the Internal Revenue Service has qualified the applicant.

(ii) Application for enrollment on account of employment in the Internal Revenue Service must be made within 3 years from the date of separation from such employment.

(iii) It shall be requisite for enrollment on account of such employment that the applicant shall have had a minimum of 5 years continuous employment in the Service during which he shall have been regularly engaged in applying and interpreting the provisions of the Internal Revenue Code and the regulations thereunder relating to income, estate, gift, employment, or excise taxes.

(iv) For the purposes of paragraph (b)(3)(iii) of this section an aggregate of 10 or more years of employment, at least 3 of which occurred within the 5 years preceding the date of application, shall be deemed the equivalent of 5 years continuous employment.

(c) *Natural persons.* Enrollment to practice may be granted only to natural persons.

(d) *Attorneys; certified public accountants.* Enrollment is not available to persons who qualify to practice under § 10.3(a) or (b).

[3] F.R. 10773, Aug. 13, 1966, as amended at 35 F.R. 13205, Aug. 19, 1970; 42 F.R. 38352, July 28, 1977]

§ 10.5 Application for enrollment.

(a) *Form; fee.* An applicant for enrollment shall file with the Commissioner of Internal Revenue an application on Form 23, properly executed under oath or affirmation. Such application shall be accompanied by a check or money order in the amount set forth on Form 23, payable to the Internal Revenue Service, which amount shall constitute a fee which shall be charged to each applicant for enrollment. The fee shall be retained by the United States whether or not the applicant is granted enrollment.

(b) *Additional information; examination.* The Commissioner, as a condition to consideration of an application for enrollment, may require the applicant to file additional information and to submit to any written or oral examination under oath or otherwise. The Commissioner shall upon written request, afford an applicant the opportunity to be heard with respect to his application for enrollment.

(c) *Temporary recognition.* Upon receipt of a properly executed application, the Commissioner may grant the applicant temporary recognition to practice pending a determination as to whether enrollment to practice should be granted. Such temporary recognition shall not be granted if the application is not regular on its face; if the information stated therein, if true, is not sufficient to warrant enrollment to practice; if there is any information before the Commissioner which indicates that the statements in the application are untrue; or which indicates that the applicant

would not otherwise qualify for enrollment. Issuance of temporary recognition shall not constitute enrollment to practice or a finding of eligibility for enrollment, and the temporary recogniton may be withdrawn at any time by the Commissioner.

(d) *Appeal from denial of application.* (1) The Commissioner, in denying an application for enrollment, shall inform the applicant as to the reason(s) therefor. The applicant may, within 30 days after receipt of the notice of denial, file a written appeal therefrom, together with his reasons in support thereof, to the Director of Practice. A decision on the appeal will be rendered by the Director of Practice as soon as practicable.

(2) A decision of the Director of Practice in substaining a denial of enrollment may be appealed to the Secretary of the Treasury within 30 days after receipt of the decision of the Director.

(Sec. 501. Pub. L. 82-137, 8b Stat. 290: 31 U.S.C. 483a).

[31 F.R. 10773, Aug. 13, 1966, as amended at 42 F.R. 38352, July 28, 1977]

§ 10.6 Enrollment.

(a) *Roster.* The Commissioner shall maintain rosters of all agents who are enrolled to practice, of all persons who have been disbarred or suspended from practice before the Internal Revenue Service, and of persons whose applications for enrollment have been denied.

(b) *Enrollment card.* The Commissioner shall issue an enrollment card to each agent who is enrolled to practice before the Internal Revenue Service after the effective date of this regulation. Each such enrollment card shall be valid so long as the holder shall remain enrolled and in good standing before the Service. Unless advised to the contrary by the Commissioner, any officer or employee of the Internal Revenue Service may consider the holder of a valid enrollment card to be duly authorized to practice before the Service.

(c) *Termination of enrollment.* The enrollment of any agent to whom an enrollment card is issued after the effective date of this regulation shall terminate at such time as such agent may become eligible to practice without enrollment under § 10.3(a) or (b), and such agent shall forthwith return his enrollment card to the Commissioner of Internal Revenue for cancellation.

(31 U.S.C. 483a)
[31 F.R. 10773. Aug. 13, 1966, as amended at 42 F.R. 38352, July 28, 1977]

§ 10.7 Limited practice; special appearances; return preparation and furnishing information.

(a) *In general.* Individuals may appear on their own behalf and may otherwise appear without enrollment, provided they present satisfactory indentificaton, in the following classes of cases:

(1) An individual may represent another individual who is his regular full-time employer, may represent a partnership of which he is a member or a regular full-time employee, or may represent without compensation a member of his immediate family.

(2) Corporations (including parents, subsidiaries or affiliated corporations), trusts, estates, associations, or organized groups may be represented by bona fide officers or regular full-time employees.

(3) Trusts, receiverships, guardianships, or estates may be represented by their trustees, receivers, guardians, administrators or executors or their regular full-time employees.

(4) Any governmental unit, agency, or authority may be represented by an officer of regular employee in the course of his official duties.

(5) Unenrolled persons may participate in rule making as provided by section 4 of the Administrative Procedure Act, 60 Stat. 238 (5 U.S.C. 1003).

(6) Enrollment is not required for representation outside of the United States before personnel of the Internal Revenue Service.

(7) Any individual who is not under disbarment or suspension from practice before the Internal Revenue Service or other practice of his profession by any other authority (in the case of attorneys, certified public accountants, and public accountants) and who signs a return as having prepared it for the taxpayer, or who prepared a return with respect to which the instructions or regulations do not require that it be signed by the person who prepared the return for the taxpayer, may appear without enrollment as the taxpayer's representative, with or without the taxpayer, before revenue agents and examining officers of the Examination Division in the offices of District Directors with respect to the tax liability of the taxpayer for the taxable year or period covered by that return. Proper authorization from the taxpayer will be required. All such persons will be subject to such rules regarding standards of conduct, the extent of their authority, and other matters as the Commissioner of Internal Revenue shall prescribe. Such persons will be permitted to represent taxpayers within those limits without enrollment, except that the Commissioner may deny permission to engage in such limited practice to any person who has engaged in conduct which would justify suspension or disbarment of any attorney, certified public accountant, or enrolled agent under the provisions of this part.

(b) *Special appearance.* The Commissioner, subject to such conditions as he deems appropriate, may authorize any person to represent another without enrollment for the purpose of a particular matter.

(c) *Preparation of tax returns and furnishing information.* Any person may prepare a tax return, may appear as a witness for the taxpayer before the Internal Revenue Service, or furnish information at the request of the Internal

Revenue Service or any of its officers or employees.

[3] F.R. 10773, Aug 13, 1966, as amended at 35 F.R. 13205. Aug. 19, 1970; 49 F.R. 6719, Feb 23, 1984]

§ 10.8 Customhouse brokers.

Nothing contained in the regulations in this part shall be deemed to affect or limit the right of a customhouse broker, licensed as such by the Commissioner of Customs in accordance with the regulations prescribed therefor, in any customs district in which he is so licensed, at the office of the District Director of Internal Revenue or before the National Office of the Internal Revenue Service, to act as a representative in respect to any matters relating specifically to the importation or exportation of merchandise under the customs or internal revenue laws, for any person for whom he has acted as a customhouse broker.

Subpart B-Duties and Restrictions Relating to Practice Before the Internal Revenue Service

§ 10.20 Information to be furnished.

(a) *To the Internal Revenue Service.* No attorney, certified public accountant, or enrolled agent shall neglect or refuse promptly to submit records or information in any matter before the Internal Revenue Service, upon proper and lawful request by a duly authorized officer or employee of the Internal Revenue Service, or shall interfere, or attempt to interfere, with any proper and lawful effort by the Internal Revenue Service or its officers or employees to obtain any such record or information, unless he believes in good faith and on reasonable grounds that such record or information is privileged or that the request for, or effort to obtain, such record or information is of doubtful legality.

(b) *To the Director of Practice.* It shall be the duty of an attorney or certified public accountant, who practices before the Internal Revenue Service, or enrolled agent, when requested by the Director of Practice, to provide the Director with any information he may have concerning violation of the regulations in this part by any person, and to testify thereto in any proceeding instituted under this part for the disbarment or suspension of an attorney, certified public accountant, or enrolled agent, unless he believes in good faith and on reasonable grounds that such information is privileged or that the request therefor is of doubtful legality.

§ 10.21 Knowledge of client's omission.

Each attorney, certified public accountant, or enrolled agent who, having been retained by a client with respect to a matter administered by the Internal Revenue Service, knows that the client has not complied with the revenue laws of the United States or has made an error in or omission from any return, document, affidavit, or other paper which the client is required by the revenue laws of the United States to execute, shall advise the client promptly of the fact of such noncompliance, error, or omission.

[42 F.R. 38352, July 28, 1977]

§ 10.22 Diligence as to accuracy.

Each attorney, certified public accountant, or enrolled agent shall exercise due diligence:

(a) In preparing or assisting in the preparation of, approving, and filing returns, documents, affidavits, and other papers relating to Internal Revenue Service matters;

(b) In determining the correctness of oral or written representations made by him to the Department of the Treasury; and

(c) In determining the correctness of oral or written representations made by him to clients with reference to any matter administered by the Internal Revenue Service.

[35 F.R. 13205, Aug. 19, 1970, as amended at 42 F.R. 38352, July 28, 1977]

§ 10.23 Prompt disposition of pending matters.

No attorney, certified public accountant, or enrolled agent shall unreasonably delay the prompt disposition of any matter before the Internal Revenue Service.

§ 10.24 Assistance from disbarred or suspended persons and former Internal Revenue Service employees.

No attorney, certified public accountant or enrolled agent, shall, in practice before the Internal Revenue Service, knowingly and directly or indirectly:

(a) Employ or accept assistance from any person who is under disbarment or suspension from practice before the Internal Revenue Service.

(b) Accept employment as associate, correspondent, or subagent from, or share fees with, any such person.

(c) Accept assistance from any former government employee where the provisions of § 10.26 of these regulations or any Federal law would be violated.

[31 F.R. 10773, Aug. 13, 1966, as amended at 35 F.R. 13205. Aug. 19, 1970, 44 F.R. 4940, Jan. 1979]

§ 10.25 Practice by partners of Government employees.

No partner of an officer or employee of the executive branch of the U:S. Government, of any

independent agent of the United States, or of the District of Columbia, shall represent anyone in any matter administered by the Internal Revenue Service in which such officer or employee of the Government participates or has participated personally and substantially as a Government employee or which is the subject of his offical responsibility.

[31 F.R. 10773, Aug. 13, 1966, as amended at 35 F.R. 13205. Aug. 19, 1970]

§ 10.26 Practice by former Government employees, their partners and their associates.

(a) *Definitions.* For purposes of § 10.26. (1) "Assist" means to act in such a way as to advise, furnish information to or otherwise aid another person, directly of indirectly.

(2) "Government employee" is another officer or employee of the United States or any agency of the United States, including a "special government employee" as defined in 18 U.S.C. 202(a), or of the District of Columbia, or of any State, or a member of Congress or of any State legislature.

(3) "Member of a firm" is a sole practitioner or an employee or associate thereof, or a partner, stockholder, associate, affiliate or employee of a partnership, joint venture, corporation, professional association or other affiliation of two or more practioners who represent non-Government parties.

(4) "Practitioner" is an attorney, certified public accountant, enrolled agent or any other person authorized to practice before the Internal Revenue Service.

(5) "Official responsibility" means the direct administrative or operating authority, whether intermediate or final, and either exercisable alone or with others, and either personally or through subordinates, to approve, disapprove, or otherwise direct Government action, with or without knowledge of the action.

(6) "Participate" or "participation" means substantial involvement as a Government employee by making decisions, or preparing or reviewing documents with or without the right to exercise a judgment of approval or disapproval, or participating in conferences or investigations, or rendering advice of a substantial nature.

(7) "Rule" includes Treasury Regulations, whether issued or under preparation for issuance as Notices of Proposed Rule Making or as Treasury Decisions, and revenue rulings and revenue procedures published in the Internal Revenue bulletin. "Rule" shall not include a "transaction" as defined in paragraph (a)(9) of this section.

(8) "Transaction" means any decision, determination, finding, letter ruling, technical advice, contract or approval or disapproval thereof, relating to a particular factual situation or situations involving a specific party or parties whose rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service, or other legal rights, are determined or immediately affected therein and to which the United States is a party or in which it has a direct and substantial interest, whether or not the same taxable periods are involved. "Transaction" does not include "rule" as defined in paragraph (a)(7) of this section.

(b) *General rules.* (1) No former Government employee shall subsequent to his Government employment, represent anyone in any matter administered by the Internal Revenue Service if the representation would violate 18 U.S.C. 207(a) or (b) or any other laws of the United States.

(2) No former Government employee who participated in a transaction shall, subsesquent to his Government employment, represent or knowingly assist, in that transaction, any person who is or was a specific party to that transaction.

(3) No former Government employee who within a period of one year prior to the termination of his Government employment had official responsibility for a transaction shall, within one year after his Government employment is ended, represent or knowingly assist in that transaction any person who is or was a specific party to that transaction.

(4) No former Government employee shall, within one year after his Government employment is ended, appear before any employee of the Treasury Department in connection with the publication, withdrawal, amendment, modification, or interpretation of a rule in the development of which the former Government employee participated or for which, within a period of one year prior to the termination of his Government employment, he had official responsibility. However, this subparagraph does not preclude such former employee from appearing on his own behalf or from representing a taxpayer before the Internal Revenue Service in connection with a transaction involving the application or interpretation of such a rule with respect to that transaction: *Provided.* That such former employee shall not utilize or disclose any confidential information acquired by the former employee in the development of the rule, and shall not contend that the rule is invalid or illegal. In addition, this subparagraph does not preclude such former employee from otherwise advising or acting for any person.

(c) *Firm representation.* (1) No member of a firm of which a former Government employee is a member may represent or knowingly assist a person who was or is a specific party in any transaction with respect to which the restrictions of paragraph (b)(1) (other than 18 U.S.C. 207(b)) or (b)(2) of this section apply to the former Government employee, in that transaction, unless:

(i) No member of the firm who had knowledge of the participation by the Government employee in the transaction initiated discussions with the Government employee concerning his becoming a member of the firm until his Government

employment is ended or six months after the termination of his participation in the transaction, whichever is earlier;

(ii) The former Government employee did not initiate any discussions concerning becoming a member of the firm while participating in the transaction or, if such discussions were initiated, they conformed with the requirement of 18 U.S.C. 208(b); and

(iii) The firm isolates the former Government employee is such a way that he does not assist in the representation.

(2) No member of a firm of which a former Government employee is a member may represent or knowingly assist a person who was or is a specific party in any transaction with respect to which the restrictions of paragraph (b)(3) of this section apply to the former employee, in that transaction unless the firm isolates the former Government employee in such a way that he does not assist in the representation.

(3) When isolation of the former Government employee is required under paragraphs (c)(1) or (c)(2) of this section, a statement affirming the fact of such isolation shall be executed under oath by the former Government employee and by a member of the firm acting on behalf of the firm, and shall be filed with the Director of Practice and in such other place and in the manner prescribed by regulation. This statement shall clearly identify the firm, the former Government employee, and transaction or transactions requiring such isolation.

(d) *Pending representation.* Practice by former Government employees, their partners and associates with respect to representation in specific matters where actual representation commenced before publication of this regulation is governed by the regulations set fourth in the June 1972 amendments to the regulations of this part (published at 37 F.R. 11676): *Provided.* That the burden of showing that representation commenced before publication is with the former Government employees, their partners and associates.

[42 F.R. 38352, July 28, 1977]

§ 10.27 Notaries.

No attorney, certified public accountant, or enrolled agent as notary public shall with respect to any matter administered by the Internal Revenue Service take acknowledgments, administer oaths, certify papers, or perform any official act in connection with matters in which he is employed as counsel, attorney, or agent, or in which he may be in any way interested before the Internal Revenue Service (26 Op. Atty. Gen. 236).

§ 10.28 Fees.

No attorney, certified public accountant, or enrolled agent shall charge an unconscionable fee for representation of a client in any matter before the Internal Revenue Service.

§ 10.29 conflicting interests.

No attorney, certified public accountant, or enrolled agent shall represent conflicting interests in his practice before the Internal Revenue Service, except by express consent of all directly interested parties after full disclosure has been made.

§ 10.30 Solicitation.

(a) *Advertising and Solicitation restriction.* (1) No attorney, certified public accountant, enrolled agent, or other individual eligible to practice before the Internal Revenue Service shall, with respect to any Internal Revenue Service matter, in any way use or participate in the use of any form of public communication containing a false, fraudulent, misleading, deceptive, unduly influencing, coercive or unfair statement or claim. For the purposes of this subsection, the prohibition includes, but is not limited to, statements pertaining to the quality of services rendered unless subject to factual verification, claims of specialized expertise not authorized by State or Federal agencies having jurisdiction over the practitioner, and statements or suggestions that the ingenuity and/or prior record of a representative rather than the merit of the matter are principal factors likely to determine the result of the matter.

(2) No attorney, certified public accountant, enrolled agent or other individual eligible to practice before the Internal Revenue Service shall make, directly or indirectly, an univited solicitation of employment, in matters related to the Internal Revenue Service. Solicitation includes, but is not limited to, in-person contacts, telephone communications, and personal mailings directed to the specific circumstances unique to the recipient. This restriction does not apply to: (i) seeking new business from an existing or former client in a related matter; (ii) solicitation by mailings, the contents of which are designed for the general public; or (iii) non-coercive in-person solicitation by those eligible to practice before the Internal Revenue Service while acting as an employee, member, or officer of an exempt organization listed in sections 501(c)(3) or (4) of the Internal Revenue code of 1954 (26 U.S.C.).

(b) *Permissible Advertising.* (1) Attorneys, certified public accountants, enrolled agents and other individuals eligible to practice before the Internal Revenue Service, may published, broadcast, or used in a dignified manner through any means of communication set forth in paragraph (d) of this section:

(i) The name, address, telephone number, and office hours of the practitioner or firm.

(ii) The names of individuals associated with the firm.

(iii) A factual description of the services offered.

(iv) Acceptable credit cards and other credit arrangements.

(v) Foreign language ability.

(vi) Membership in pertinent, professional organizations.

(vii) Pertinent professional licenses.

(viii) A statement that an individual's or firm's practice is limited to certain areas.

(ix) In the case of an enrolled agent, the phrase "enrolled to represent taxpayers before the Internal Revenue Service" or "enrolled to practice before the Internal Revenue Service."

(x) Other facts relevant to the section of practitioner in matters related to the Internal Revenue Service which are not prohibited by these regulations.

(2) Attorneys, certified public accountants, enrolled agents and other individuals eligible to practice before the Internal Revenue Service may use, to the extent they are consistent with the regulations in this section, customary biographical insertions in approved law lists and reputable professional journals and directories, as well as professional cards, letterheads and announcements: *Provided.* That: (i) attorneys do not violate applicable standards of ethical conduct adopted by the American Bar Association, (ii) certified public accountants do not violate applicable standards of ethical conduct adopted by the American Institute of Certified Public Accountants, and (iii) enrolled agents do not violate applicable standards of ethical conduct adopted by either the National Society of Public Accountants or the National Association of Enrolled Agents.

(c) *Fee Information.* (1) Attorneys, certified public accountants, enrolled agents and other individuals eligible to practice before the Internal Revenue Service may disseminate the following fee information:

(i) Fixed fees for specific routine services.

(ii) Hourly rates.

(iii) Range of fees for particular services.

(iv) Fee charged for an initial consultation.

(2) Attorneys, certified public accountants, enrolled agents and other individuals eligible to practice before the Internal Revenue Service may also publish the availability of a written schedule of fees.

(3) Attorneys, certified public accountants, enrolled agents and other individuals eligible to practice before the Internal Revenue Service shall be bound to charge the hourly rate, the fixed fee for specific routine services, the range of fees for particular services, or the fee for an initial consultation published for a reasonable period of time, but no less than thirty days from the last publication of such hourly rate or fees.

(d) *Communications.* Communications, including fee information, shall be limited to professional lists, telephone directories, print media, permissible mailings as provided in these regulations, radio and television. In the case of radio and television broadcasting, the broadcast shall be pre-recorded and the practitioner shall retain a recording of the actual audio transmission.

(e) *Improper Associations.* An attorney, certified public accountant or enrolled agent may, in matters related to the Internal Revenue Service, employ or accept employment or assistance as an associate, correspondent, or sub-agent from, or share fees with any person or entity who, to the knowledge of the practitioner, obtains clients or otherwise practices in a manner forbidden under this section: *Provided.* That a practitioner does not, directly or indirectly, act or hold himself out as an Internal Revenue Service practitioner in connection with that relationship. Nothing herein shall prohibit an attorney, certified public accountant, or enrolled agent from practice before the Internal Revenue Service in a capacity other than that described above.

[44 F.R. 4940, Jan. 24, 1979]

§ 10.31 Negotiation of taxpayer refund checks.

No attorney, certified public accountant or enrolled agent who is an income tax return preparer shall endorse or otherwise negotiate any check made in respect of income taxes which is issued to a taxpayer other than the attorney, certified public accountant or enrolled agent.

[42 F.R. 38353, July 28, 1977]

§ 10.32 Practice of law.

Nothing in the regulations in this part shall be construed as authorizing persons not members of the bar to practice law.

[31 F.R. 10773, Aug. 13, 1966. Redesigned at 42 F.R. 38353, July 28, 1977]

§ 10.33 Tax shelter opinions.

(a) *Tax shelter opinions and offering materials.* A practitioner who provides a tax shelter opinion analyzing the Federal tax effects of a tax shelter investment shall comply with each of the following requirements:

(1) *Factual matters.* (i) The practitioner must make inquiry as to all relevant facts, be satisfied that the material facts are accurately and completely described in the offering materials, and assure that any representations as to future activities are clearly indentified, reasonable and complete.

(ii) A practitioner may not accept as true asserted facts pertaining to the tax shelter which he/she should not, based on his/her background and knowledge, reasonably believe to be true. However, a practitioner need not conduct an audit or independent verification of the asserted facts, or assume that a client's statement of the facts cannot be relied upon, unless he/she has reason to believe that any relevant facts asserted to him/her are untrue.

(iii) If the fair market value of property or the expected financial performance of an investment is relevant to the tax shelter, a practitioner may

not accept an appraisal or financial projection as support for the matters claimed therein unless:

(A) The appraisal or financial projection makes sense on its face;

(B) The practitioner reasonably believes that the person making the appraisal or financial projection is competent to do so and is not of dubious reputation; and

(C) The appraisal is based on the definition of fair market value prescribed under the relevant Federal tax provisions.

(iv) If the fair market value of purchased property is to be established by reference to its stated purchase price, the practitioner must examine the terms and conditions upon which the property was (or is to be) purchased to determine whether the stated purchase price reasonably may be considered to be its fair market value.

(2) *Relate law to facts.* The practitioner must relate the law to the actual facts and, when addressing issues based on future activities, clearly identify what facts are assumed.

(3) *Identification of material issues.* The practitioner must ascertain that all material Federal tax issues have been considered, and that all of those issues which involve the reasonable possibility of a challenge by the Internal Revenue Service have been fully and fairly addressed in the offering materials.

(4) *Opinion on each material issue.* Where possible, the practitioner must provide an opinion whether it is more likely than not that an investor will prevail on the merits of each material tax issue presented by the offering which involves a reasonable possibility of a challenge by the Internal Revenue Service. Where such an opinion cannot be given with respect to any material tax issue, the opinion should fully describe the reasons for the practitioner's inability to opine as to the likely outcome.

(5) *Overall evaluation.* (i) Where possible, the practitioner must provide an overall evaluation whether the material tax benefits in the aggregate more likely than not will be realized. Where such an overall evaluation cannot be given, the opinion should fully describe the reasons for the practitioner's inability to make an overall evaluation. Opinions concluding that an overall evaluation cannot be provided will be given special scrutiny to determine if the stated reasons are adequate.

(ii) A favorable overall evaluation may not be rendered unless it is based on a conclusion that substantially more than half of the material tax benefits, in terms of their financial impact on a typical investor, more likely than not will be realized if challenged by the Internal Revenue Service.

(iii) If it is not possible to give an overall evaluation, or if the overall evaluation is that the material tax benefits in the aggregate will not be realized, the fact that the practitioner's opinion does not constitute a favorable overall evaluation, or that it is an unfavorable overall evaluation, must be clearly and prominently disclosed in the ofering materials.

(iv) The following examples illustrate the principles of this paragraph:

Example (1). A limited partnership acquires real property in a sale-leaseback transaction. The principal tax benefits offered to investing partners consist of depreciation and interest deductions. Lesser tax benefits are offered to investors by reason of several deductions under Internal Revenue Code section 162 (ordinary and necessary business expenses). If a practitioner concludes that it is more likely than not that the partnership will not be treated as the owner of the property for tax purposes (which is required to allow the interest and depreciation deductions), then he/she may not opine to the effect that it is more likely than not that the material tax benefits in the aggregate will be realized, regardless of whether favorable opinions may be given with respect to the deductions claimed under Code section 162.

Example (2). A corporation electing under subchapter S of the Internal Revenue Code is formed to engage in research and development activities. The offering materials forecast that deductions for research and experimental expenditures equal to 75% of the total investment in the corporation will be available during the first two years of the corporation's operations, other expenses will account for another 15% of the total investment, and that little or no gross income will be received by the corporation during this period. The practitioner concludes that it is more likely than not that deductions for research and experimental expenditures will be allowable. The practitioner may render an opinion to the effect that based on this conclusion, it is more likely than not that the material tax benefits in the aggregate will be realized, regardless of whether he/she can opine that it is more likely than not that any of the other tax benefits will be achieved.

Example (3). An investment program is established to acquire offsetting positions in commodities contracts. The objective of the program is to close the loss positions in year one and to close the profit positions in year two. The principal tax benefit offered by the program is a loss in the first year, coupled with the deferral of offsetting gain until the following year. The practitioner concludes that the losses will not be deductible in year one. Accordingly, he/she may not render an opinion to the effect that it is more likely than not that the material tax benefits in the aggregate will be realized, regardless of the fact that he/she is of the opinion that losses not allowable in year one will be allowable in year two, because the principal tax benefit offered is a one-year deferral of income.

Example (4). A limited partnership is formed to acquire, own and operate residential rental real estate. The offering material forecasts gross income of $2,000,000 and total deductions of $10,000,000, resulting in net losses of $8,000,000 over the first six taxable years. Of the total deductions, depreciation and interest are projected to be $7,000,000, and other deductions

$3,000,000. The practitioner concludes that it is more likely than not all of the depreciation and interest deductions will be allowable, and that it is more likely than not that the other deductions will not be allowed. The practitioner may render and opinion to the effect that it is more likely than not that the material tax benefits in the aggregate will be realized.

(6) *Description of opinion.* The practitioner must assure that the offering materials correctly and fairly represent the nature and extent of the tax shelter opinion.

(b) *Reliance on other opinions*—(1) *In general.* A practitioner may provide an opinion on less than all of the material tax issues only if:

(i) At least one other competent practitioner provides an opinion on the likely outcome with respect to all of the other material tax issues which involve a reasonable possibility of challenge by the Internal Revenue Service, and an overall evalution whether the material tax benefits in the aggregate more likely than not will be realized, which is disseminated in the same manner as the practitioner's opinion; and

(ii) The practitioner, upon reviewing such other opinions and any offering materials, has no reason to believe that the standards of paragraph (a) of this section have not been complied with. Notwithstanding the foregoing, a practitioner who has not been retained to provide an overall evaluation whether the material tax benefits in the aggregate more likely than not will be realized may issue an opinion on less than all the material tax issues only if he/she has no reason to believe, based on his/her knowledge and experience, that the overall evaluation given by the practitioner who furnished the overall evaluation is incorrect on its face.

(2) *Forecasts and projections.* A practitioner who is associated with forecasts or projections relating to or based upon the tax consequences of the tax shelter offering that are included in the offering materials, or are disseminated to potential investors other than the practitioner's clients, may rely on the opinion of another practitioner as to any or all material tax issues, provided that the practitioner who desires to rely on the other opinion has no reason to believe that the standards of paragraph (a) of this section have not been complied with by the practitioner rendering such other opinion, and the requirements of paragraph (b)(1) of this section are satisfied. The practitioner's report shall disclose any material tax issue not covered by, or incorrectly opined upon, by the other opinion, and shall set forth his/her opinion with respect to each such issue in a manner that satisfies the requirements of paragraph (a) of this section.

(c) *Definitions.* For purposes of this section:

(1) "Practitioner" is any person authorized under § 10.3 of this part to practice before the Internal Revenue Service.

(2) A "tax shelter," as the term is used in this section, is an investment which has as a significant and intended feature for Federal income or excise tax purposes either of the following attributes: (i) Deductions in excess of income from the investment being available in any year to reduce income from other sources in that year, or (ii) credits in excess of the tax attributable to the income from the investment being available in any year to offset taxes on income from other sources in that year. Excluded from the term are municipal bonds; annuities; family trusts [but not including schemes or arrangements that are marketed to the public other than in a direct practitioner-client relationship]; qualified retirement plans; individual retirement accounts, stock option plans; securities issued in a corporate reorganization; mineral development ventures, if the only tax benefit would be percentage depletion; and real estate where it is anticipated that in no year is it likely that deductions will exceed the tax attributable to the income from the investment in that year. Whether an investment is intended to have tax shelter features depends on the objective facts and circumstances of each case. Significant weight will be given to the features described in the offering materials to determine whether the investment is a tax shelter.

(3) A "tax shelter opinion," as the term is used in this section, is advice by a practitioner concerning the Federal tax aspects of a tax shelter either appearing or referred to in the offering materials, or used or referred to in connection with sales promotion efforts, and directed to persons other than the client who engaged the practitioner to give the advice. The term includes the tax aspects or tax risks portion of the offering materials prepared by or at the direction of a practitioner, whether or not a separate opinion letter is issued or whether or not the practitioner's name is referred to in the offering materials or in connection with the sales promotion efforts. In addition, a financial forcast or projection prepared by a practitioner is a tax shelter opinion if it is predicated on assumptions regarding Federal tax aspects of the investment, and it meets the other requirements of the first sentence of this subparagraph. The term does not, however, include rendering advice solely to the offeror or reviewing parts of the offering materials, so long as neither the name of the practitioner, nor the fact that a practitioner has rendered advice concerning the tax aspects, is referred to in the offering materials or in connection with the sales promotion efforts.

(4) A "material" tax issue as the term is used in this section is (i) any Federal income or excise tax issue relating to a tax shelter that would make a significant contribution toward sheltering from Federal taxes income from other sources by providing deductions in excess of the income from the tax shelter investment in any year, or tax credits available to offset tax liabilities in excess of the tax attributable to the tax shelter investment in any year; (ii) any other Federal income or excise tax issue relating to a tax shelter that could have a significant impact (either beneficial or adverse) on a tax shelter investor under any reasonably foreseeable circumstances (e.g., depreciation or investment tax credit recapture,

availability of long-term capital gain treatment, or realization of taxable income in excess of cash flow, upon sale or other disposition of the tax shelter investment); and (iii) the potential applicability of penalties, additions to tax, or interest charges that reasonably could be asserted against a tax shelter investor by the Internal Revenue Service with respect to the tax shelter. The determination of what is material is to be made in good faith by the practitioner, based on information available at the time the offering materials are circulated.

Subpart C—Rules Applicable to Disciplinary Proceedings

§ 10.50 Authority to disbar or suspend.

Pursuant to section 3 of the Act of July 7, 1884, 23 Stat. 258 (31 U.S.C. 1026), the Secretary of the Treasury, after due notice and opportunity for hearing, may suspend or disbar from practice before the Internal Revenue Service any attorney, certified public accountant, or enrolled agent shown to be incompetent, disreputable or who refuses to comply with the rules and regulations in this part or who shall, with intent to defraud, in any manner willfully and knowingly deceive, mislead, or threaten any claimant or prospective claimant, by word, circular, letter, or by advertisement.

[31 F.R. 10773, Aug. 13, 1966, as amended at 35 F.R. 13205, Aug. 19, 1970]

§ 10.51 disreputable conduct.

Disreputable conduct for which an attorney, certified public accountant, or enrolled agent may be disbarred or suspended from practice before the Internal Revenue Service includes, but is not limited to:

(a) Conviction of any criminal offense under the revenue laws of the United States, or of any offense involving dishonesty, or breach of trust.

(b) Giving false or misleading information, or participating in any way in the giving of false or misleading information to the Department of the Treasury or any officer or employee thereof, or to any tribunal authorized to pass upon Federal tax matters, in connection with any matter pending or likely to be pending before them, knowing such information to be false or misleading. Facts or other matters contained in testimony, Federal tax returns, financial statements, applications for enrollment, affidavits, declarations, or any other document or statement, written or oral, are included in the term "information."

(c) Solicitation of employment as prohibited under § 10.30 of this part, the use of false or misleading representations with intent to deceive a client or prospective client in order to procure employment, or intimating that the practitioner is able improperly to obtain special consideration or action from the Internal Revenue Service or officer or employee thereof.

(d) Willfully failing to make Federal tax return in violation of the revenue laws of the United States, or evading, attempting to evade, or participating in any way in evading or attempting to evade any Federal tax or payment thereof, knowingly counseling or suggesting a client or prospective client an illegal plan to evade Federal taxes or payment thereof, or concealing assets of himself or another to evade Federal taxes or payment thereof.

(e) Misappropriation of, or failure properly and promptly to remit funds received from a client for the purpose of payment of taxes or other obligations due the United States.

(f) Directly or indirectly attempting to influence, or offering or agreeing to attempt to influence, the offical action of any officer or employee of the Internal Revenue Service by the use of threats, false accusations, duress or coercion, by the offer of any special inducement or promise of advantage or by the bestowing of any gift, favor or thing of value.

(g) Disbarment or suspension from practice as an attorney, certified public accountant, public accountant, or actuary by any duly constituted authority of any State, possession, territory, Commonwealth, the District of Columbia, any Federal court of record, or any Federal agency, body or board.

(h) Knowingly aiding and abetting another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person. Maintaining a partnership for the practice of law, accountancy, or other related professional service with a person who is under disbarment from practice before the Service shall be presumed to be a violation of this provision.

(i) Contemptuous conduct in connection with practice before the Internal Revenue Service, including the use of abusive language, making false accusations and statements knowing them to be false, or circulating or publishing malicious or libelous matter.

(j) Giving a false opinion, knowingly, recklessly, or through gross incompetence, including an opinion which is intentionally or recklessly misleading, or a pattern of providing incompetent opinions on questions arising under the Federal tax laws. False opinions described in this paragraph include those which reflect or result from a knowing misstatement of fact or law; from an assertion of a position known to be unwarranted under existing law; from counseling or assisting in conduct known to be illegal or fraudulent; from concealment of matters required by law to be revealed; or from conscious disregard of information indicating that material facts expressed in the tax opinion or offering material are false or misleading. For the pupose of this paragraph, reckless conduct is a highly unreasonable omission or misrepresentation, involving not merely simple or inexcusable negligence, but

an extreme departure from the standards of ordinary care that is either known or is so obvious that the competent practitioner must or should have been aware of it. Gross incompetence includes conduct that reflects gross indifference, preparation which is grossly inadequate under the circumstances, and a consistent failure to perform obligations to the client.

[Dept. Circ. 230, Rev., 31 F.R. 10773, Aug. 13, 1966, as amended at 35 F.R. 13205, Aug. 19, 1970, 42 F.R. 38353, July 28, 1977; 44 F.R. 4944, Jan. 24, 1979; 49 F.R. 6719, Feb. 23, 1984]

§ 10.52 Violation of regulations.

(a) *In General.* Any attorney, certified public accountant, or enrolled agent may be disbarred or suspended from practice before the Internal Revenue Service for willful violation of any of the regulations contained in this part.

(b) *Tax shelter opinions.* An attorney, certified public accountant, enrolled agent or enrolled actuary may be disbarred or suspended from practice before the Internal Revenue Service for violating any part of § 10.33 of this part, if such violation is willfull, reckless or through gross incompetence (within the meaning of § 10.51(j) of this part); or if the violation is part of a pattern of providing tax shelter opinions that fail to comply with § 10.33 of this part.

§ 10.53 Receipt of information concerning attorneys, certified public accountants and enrolled agents.

If an officer or employee of the Internal Revenue Service has reason to believe that an attorney, certified public accountant, or enrolled agent has violated any provision of this part, or if any such officer or employee receives information to that effect, he shall promptly make a written report thereof, which report or a copy thereof shall be forwarded to the Director of Practice. If any other person has information of such violations, he may make a report thereof to the Director of Practice or to any officer or employee of the Internal Revenue Service.

§ 10.54 Institution of proceeding.

Whenever the Director of Practice has reason to believe that any attorney, certified public accountant, or enrolled agent has violated any provision of the laws or regulations governing practice before the Internal Revenue Service, he may reprimand such person or institute a proceeding for disbarment or suspension of such person. The proceeding shall be instituted by a complaint which names the respondent and is signed by the Director of Practice and filed in his office. Except in cases of willfulness, or where time, the nature of the proceeding, or the public interest does not permit, a proceeding will not be instituted under this section until facts or conduct which may warrant such action have been called to the attention of the proposed respondent in writting and he has been accorded opportunity to demonstrate or achieve compliance with all lawful requirements.

§ 10.55 Conferences.

(a) *In general.* The Director of Practice may confer with an attorney, certified public accountant, or enrolled agent concerning allegations of misconduct irrespective of whether a proceeding for disbarment or suspension has been instituted against him. If such conference results in a stipulation in connection with a proceeding in which such person is the respondent, the stipulation may be entered in the record at the instance of either party to the proceeding.

(b) *Resignation or voluntary suspension.* An attorney, certified public accountant, or enrolled agent, in order to avoid the institution or conclusion of disbarment or suspension proceeding, may offer his consent to suspension from practice before the Internal Revenue Service. An enrolled agent may also offer his resignation. The Director of Practice, in his discretion, may accept the offered resignation of an enrolled agent and may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

[31 F.R. 10773, Aug. 13, 1966, as amended at 35 F.R. 13206, Aug. 19, 1970]

§ 10.56 Contents of complaint.

(a) *Charges.* A complaint shall give a plain and concise description of the allegations which constitute the basis for the proceeding. A complaint shall be deemed sufficient if it fairly informs the respondent of the charges against him so that he is able to prepare his defense.

(b) *Demand for answer.* In the complaint, or in a separate paper attached to the complaint, notification shall be given of the place and time within which the respondent shall file his answer, which time shall not be less than 15 days from the date of service of the complaint, and notice shall be given that a decision by default may be rendered against the respondent in the event he fails to file his answer as required.

[31 F.R. 10773, Aug. 13, 1966, as amended at 42 F.R. 38353, July 28, 1977]

§ 10.57 Service of complaint and other papers.

(a) *Complaint.* The complaint or a copy thereof may be served upon the respondent by certified mail, or first-class mail as hereinafter provided; by delivering it to the respondent or his attorney or agent of record either in person or by leaving it at the office or place of business of the respondent, attorney or agent; or in any other manner which has been agreed to by the respondent. Where the service is by certified mail, the return post office receipt duly signed by or on behalf of the respondent shall be proof of ser-

vice. If the certified matter is not claimed or accepted by the respondent and is returned undelivered, complete service may be made upon the respondent by mailing the complaint to him by first-class mail, addressed to him at the address under which he is enrolled or at the last address known to the Director of Practice. If service is made upon the respondent or his attorney or agent of record in person or by leaving the complaint at the office or place of business of the respondent, attorney or agent, the verified return by the person making service, setting forth the manner of service, shall be proof of such service.

(b) *Service of papers other than complaint.* Any paper other than the complaint may be served upon an attorney, certified public accountant, or enrolled agent as provided in paragraph (a) of this section or by mailing the paper by first-class mail to the respondent at the last address known to the Director of Practice, or by mailing the paper by first-class mail to the respondent's attorney or agent or record. Such mailing shall constitute complete service. Notices may be served upon the respondent or his attorney or agent of record by telegraph.

(c) *Filing of papers.* Whenever the filing of a paper is required or permitted in connection with a disbarment or suspension proceeding, and the place of filing is not specified by this subpart or by rule or order of the Administrative Law Judge, the paper shall be filed with the Director of Practice, Treasury Department, Washington, D.C. 20220. All papers shall be filed in duplicate.

[Dept. Circ. 230, Rev., 31 F.R. 10773 Aug. 13, 1966, as amended at 31 F.R. 13992, Nov. 2, 1966; 42 F.R. 38354, July 28, 1977]

§ 10.58 Answer.

(a) *Filing.* The respondent's answer shall be filed in writing within the time specified in the complaint or notice of institution of the proceeding, unless on application the time is extended by the Director of Practice or the Administrative Law Judge. The answer shall be filed in duplicate with the Director of Practice.

(b) *Contents.* The answer shall contain a statement of facts which constitute the grounds of defense, and it shall specifically admit or deny each allegation set forth in the complaint, except that the respondent shall not deny a material allegation in the complaint which he knows to be true, or state that he is without sufficient information to form a belief when in fact he possesses such information. The respondent may also state affirmatively special matters of defense.

(c) *Failure to deny or answer allegations in the complaint.* Every allegation in the complaint which is not denied in the answer shall be deemed to be admitted and may be considered as proved, and no further evidence in respect of such allegation need be adduced at a hearing. Failure to file an answer within the time prescribed in the notice to the respondent, except as the time for answer is extended by the Director of Practice or the Administrative Law Judge, shall constitute an admission of the allegations of the complaint and a waiver of hearing, and the Administrative Law Judge may make his decision by default without a hearing or further procedure.

[31 F.R. 10773, Aug. 13, 1966, as amended at 42 F.R. 38354, July 28, 1977]

§ 10.59 Supplemental charges.

If it appears that the respondent in his answer, falsely and in bad faith, denies a material allegation of fact in the complaint or states that the respondent has no knowledge sufficient to form a belief, when he in fact possesses such information, or if it appears that the respondent has knowingly introduced false testimony during proceedings for his disbarment or suspension, the Director of Practice may thereupon file supplemental charges against the respondent. Such supplemental charges may be tried with other charges in the case, provided the respondent is given due notice thereof and is afforded an opportunity to prepare a defense thereto.

§ 10.60 Reply to answer.

No reply to the respondent's answer shall be required, and new matter in the answer shall be deemed to be denied, but the Director of Practice may file a reply in his discretion or at the request of the Administrative Law Judge.

[31 F.R. 10773, Aug. 13, 1966, as amended at 42 F.R. 38354, July 28, 1977]

§ 10.61 Proof; variance; amendment of pleadings.

In the case of a variance between the allegations in a pleading and the evidence adduced in support of the pleading, the Administrative Law Judge may order or authorize amendment of the pleading to conform to the evidence: *Provided,* That the party who would otherwise be prejudged by the amendment is given reasonable opportunity to meet the allegations of the pleading as amended; and the Administrative Law Judge shall make findings on any issue presented by the pleadings as so amended.

[31 F.R. 10773. Aug. 13, 1966, as amended at 42 F.R. 38354, July 28, 1977]

§ 10.62 Motions and requests.

Motions and requests may be filed with the Director of Practice or with the Administrative Law Judge.

[31 F.R. 10773, Aug. 13, 1966, as amended at 42 F.R. 38354, July 28, 1977]

§ 10.63 Representation.

A respondent or proposed respondent may appear in person or he may be represented by

counsel or other representative who need not be enrolled to practice before the Internal Revenue Service. The Director may be represented by an attorney or other employee of the Internal Revenue Service.

§ 10.64 Administrative Law Judge.

(a) *Appointment:* An Administrative Law Judge appointed as provided by 5 U.S.C. 3105 (1966), shall conduct proceedings upon complaints for the disbarment or suspension of attorneys, certified public accountants, or enrolled agents.

(b) *Powers of Administrative Law Judge.* Among other powers, the Administrative Law Judge shall have authority, in connection with any disbarment or suspension proceeding assigned or referred to him, to do the following:

(1) Administer oaths and affirmations;

(2) Make rulings upon motions and requests, which rulings may not be appealed from prior to the close of a hearing except, at the discretion of the Administrative Law Judge, in extraordinary circumstances;

(3) Determine the time and place of hearing and regulate its course and conduct;

(4) Adopt rules of procedure and modify the same from time to time as occasion requires for the orderly disposition of proceedings;

(5) Rule upon offers of proof, receive relevant evidence, and examine witnesses;

(6) Take or authorize the taking of depositions;

(7) Receive and consider oral or written argument on facts or law;

(8) Hold or provide for the holding of conferences for the settlement or simplification of the issues by consent of the parties;

(9) Perform such acts and take such measures as are necessary or appropriate to the efficient conduct of any proceeding; and

(10) Make initial decisions.

[31 F.R. 10773, Aug. 13, 1966, as amended at 42 F.R. 38353, 38354, July 28, 1977]

§ 10.65 Hearings.

(a) *In general.* The Administrative Law Judge shall preside at the hearing on a complaint for the disbarment of suspension of an attorney, certified public accountant, or enrolled agent. Hearings shall be stenographically recorded and transcribed and the testimony of witnesses shall be taken under oath or affirmation. Hearings will be conducted pursuant to 5 U.S.C. 556 (1966).

(b) *Failure to appear.* If either party to the proceeding fails to appear at the hearing, after due notice thereof has been sent to him, he shall be deemed to have waived the right to a hearing and the Administrative Law Judge may make his decision against the absent party by default.

[31 F.R. 10773, Aug. 13, 1966. as amended at 42 F.R. 38354, July 28, 1977]

§ 10.66 Evidence.

(a) *In general.* The rules of evidence prevailing in courts of law and equity are not controlling in hearings on complaints for the disbarment or suspension of attorneys, certified public accountants, and enrolled agents. However, the Administrative Law Judge shall exclude evidence which is irrelevant, immaterial, or unduly repetitious.

(b) *Depositions.* The deposition of any witness taken pursuant to § 10.67 may be admitted.

(c) *Proof of documents.* Offical documents, records and papers of the Internal Revenue Service and the Office of Director of Practice shall be admissible in evidence without the production of an officer or employee to authenticate them. Any such documents, records, and papers may be evidenced by a copy attested or identified by an officer or employee of the Internal Revenue Service or the Treasury Department, as the case may be.

(d) *Exhibits.* If any document, record, or other paper is introduced in evidence as an exhibit, the Administrative Law Judge may authorize the withdrawal of the exhibit subject to any conditions which he deems proper.

(e) *Objections.* Objections to evidence shall be in short form, stating the grounds of objection relied upon, and the record shall not include argument thereon, except as ordered by the Administrative Law Judge. Rulings on such objections shall be a part of the record. No exception to the ruling is necessary to preserve the rights of the parties.

[31 F.R. 10773, Aug. 13, 1966, as amended at 35 F.R. 13206, Aug. 19, 1970; 42 F.R. 38354, July 28, 1977]

§ 10.67 Depositions.

Depositions for use at a hearing may, with the written approval of the Administrative Law Judge be taken by either the Director of Practice or the respondent or their duly authorized representatives. Depositions may be taken upon oral or written interrogatories, upon not less than 10 days written notice to the other party before any officer duly authorized to administer an oath for general purposes or before an officer or employee of the Internal Revenue Service who is authorized to administer an oath in internal revenue matters. Such notice shall state the names of the witnesses and the time and place where the depositions are to be taken. The requirement of 10 days' notice may be waived by the parties in writing, and depositions may then be taken from the persons and at the times and places mutually agreed to by the parties. When a deposition is taken upon written interrogatories, any cross-examination shall be upon written interrogatories. Copies of such written interrogatories shall be served upon the other party with the notice, and copies of any written cross-interrogation shall be mailed or delivered to the opposing party at least 5 days before the date of taking the depositions, unless the parties mutually agree

otherwise. A party upon whose behalf a deposition is taken must file it with the Administrative Law Judge and serve one copy upon the opposing party. Expenses in the reporting of depositions shall be borne by the party at whose instance the deposition is taken.

[31 F.R. 10773, Aug. 13, 1966, as amended at 42 F.R. 38354, July 28, 1977]

§ 10.68 Transcript.

In case where the hearing is stenographically reported by a Government contract reporter, copies of the transcript may be obtained from the reporter at rates not to exceed the maximum rates fixed by contract between the Government and the reporter. Where the hearing is stenographically reported by a regular employee of the Internal Revenue Service, a copy thereof will be supplied to the respondent either without charge or upon the payment of a reasonable fee. Copies of exhibits introduced at the hearing or at the taking of depositions will be supplied to the parties upon the payment of a reasonable fee (Sec. 501, Pub. L. 82-137, 65 Stat. 290 (31 U.S.C. 483a)).

[31 F.R. 10773, Aug. 13, 1966, as amended at 42 F.R. 38354, July 28, 1977]

§ 10.69 Proposed findings and conclusions.

Except in cases where the respondent has failed to answer the complaint or where a party has failed to appear at the hearing, the Administrative Law Judge prior to making his decision, shall afford the parties a reasonable opportunity to submit proposed findings and conclusions and supporting reasons therefor.

[31 F.R. 10773, Aug. 13, 1966, as amended at 42 F.R. 38354, July 28, 1977]

§ 10.70 Decision of the Administrative Law Judge.

As soon as practicable after the conclusion of a hearing and the receipt of any proposed findings and conclusions timely submitted by the parties, the Administrative Law Judge shall make the initial decision in the case. The decision shall include (a) a statement of findings and conclusions, as well as the reasons or basis therefor, upon all the material issues of fact, law, or discretion presented on the record, and (b) an order of disbarment, suspension, or reprimand or an order of dismissal of the complaint. The Administrative Law Judge shall file the decision with the Director of Practice and shall transmit a copy thereof to the respondent or his attorney of record. In the absence of an appeal to the Secretary of the Treasury, or review of the decision upon motion of the Secretary, the decisison of the Administrative Law Judge shall without further proceedings become the decision of the Secretary of the Treasury 30 days from the date of the Administrative Law Judge's decision.

[31 F.R. 10773, Aug. 13, 1966, as amended at 42 F.R. 38354, July 28, 1977]

§ 10.71 Appeal to the Secretary.

Within 30 days from the date of the Administrative Law Judge's decision, either party may appeal to the Secretary of the Treasury. The appeal shall be filed with the Director of Practice in duplicate and shall include exceptions to the decision of the Administrative Law Judge and supporting reasons for such exceptions. If an appeal is filed by the Director of Practice, he shall transmit a copy thereof to the respondent. Within 30 days after receipt of an appeal or copy thereof, the other party may file a reply brief in duplicate with the Director of Practice. If the reply brief is filed by the Director, he shall transmit a copy of it to the respondent. Upon the filing of an appeal and a reply brief, if any, the Director of Practice shall transmit the entire record to the Secretary of the Treasury.

[31 F.R. 10773, Aug. 13, 1966, as amended at 42 F.R. 38354, July 28, 1977]

§ 10.72 Decision of the Secretary.

On appeal from or review of the initial decision of the Administrative Law Judge, the Secretary of the Treasury will make the agency decision. In making his decision the Secretary of the Treasury will review the record or such portions thereof as may be cited by the parties to permit limiting of the issues. A copy of the Secretary's decision shall be transmitted to the respondent by the Director of Practice.

[31 F.R. 10773, Aug. 13, 1966, as amended at 42 F.R. 38354, July 28, 1977]

§ 10.73 Effect of disbarment or suspension; surrender of card.

In case the final order against the respondent is for disbarment, the respondent shall not thereafter be permitted to practice before the Internal Revenue Service unless and until authorized to do so by the Director of Practice pursuant to § 10.75. In case the final order against the respondent is for suspension, the respondent shall not thereafter be permitted to practice before the Internal Revenue Service during the period of suspension. If an enrolled agent is disbarred or suspended, he shall surrender his enrollment card to the Director of Practice for cancellation, in the case of disbarment, or for retention during the period of suspension.

§ 10.74 Notice of disbarment or suspension.

Upon the issuance of a final order disbarring or suspending an attorney, certified public ac-

countant, or enrolled agent, the Director of Practice shall give notice thereof to appropriate officers and employees of the Internal Revenue Service and to interested departments and agencies of the Federal Government. Notice in such manner as the Director of Practice may determine may be given to the proper authorities of the State by which the disbarred or suspended person was licensed to practice as an attorney or accountant.

§ 10.75 Petition for reinstatement.

The Director of Practice may entertain a petition for reinstatement from any person disbarred from practice before the Internal Revenue Service after the expiration of 5 years following such disbarment. Reinstatement may not be granted unless the Director of Practice is satisfied that the petitioner, thereafter, is not likely to conduct himself contrary to the regulations in this part, and that granting such reinstatement would not be contrary to the public interest.

[31 F.R. 10773, Aug. 13, 1966, as amended at 35 F.R. 13206, Aug 19, 1970]

§ 10.76 Advisory committee.

For purposes of advising the Director of Practice whether an individual may have violated § 10.33 of this part, the Director of Practice is authorized to establish an Advisory Committee, composed of at least five individuals authorized to practice before the Internal Revenue Service. Under procedures established by the Director of Practice, such Advisory Committee shall, at the request of the Director of Practice, review and make recommendations with regard to alleged violations of § 10.33 of this part.

Subpart D—General Provisions

§ 10.90 Records.

(a) *Availability.* There are made available to public inspection at the Office of the Commissioner of Internal Revenue the roster of all persons enrolled to practice and the roster of all persons disbarred or suspended from practice. Other records may be disclosed upon specific request, in accordance with the disclosure regulations of the Internal Revenue Service and the Office of the Secretary.

(b) *Disciplinary procedures.* A request by a practitioner that a hearing in a disciplinary proceeding concerning him be public, and that the record thereof be made available for inspection by interested persons may be granted if agreement is reached by stipulation in advance to protect from disclosure tax information which is confidential, in accordance with the applicable statutes and regulations.

§ 10.91 Effective date of regulations.

The regulations on this part shall become effective on August 29, 1977, and shall supersede all prior regulations related to practice before the Internal Revenue Service except to the extent and subject to the conditions set forth in § 10.26(d).

[42 F.R. 38354, July 28, 1977]

§ 10.92 Saving clause.

Any proceeding for the disbarment or suspension of an attorney, certified public accountant, or enrolled agent, instituted but not closed prior to the effective date of these revised regulations, shall not be affected by such regulations, except that any such proceeding based solely on conduct which would not justify disbarment or suspension under the provisions of the part as revised shall be dismissed. Any proceeding for disbarment or suspension based on conduct engaged in prior to the effective date of these regulations may be instituted subsequent to such effective date, provided that such conduct would continue to justify disbarment or suspension under the provisions of this part as revised.

§ 10.93 Special orders.

The Secretary of the Treasury reserves the power to issue such special orders as he may deem proper in any cases within the purview of this part.

[SEAL] Robert M. Kimmitt
General Counsel, Department of the Treasury,

[FR Doc. 84-4814 Filed 2-22-84; 8:45 am]

Treasury Department Order No. 150-106

Relocation of the Nevada Internal Revenue Service District from Reno to Las Vegas

Dated: February 8, 1985

Under the authority vested in the President to establish Internal Revenue Districts by Section 7621 of the Internal Revenue Code, as amended, and as delegated to the Secretary of the Treasury by Executive Order 10289, 31 U.S.C. §321, Reorganization Plan No. 1 of 1952 as made applicable to the Internal Revenue Code of 1954 by Section 7804(a), and Executive Order 10574, and delegated to me by Treasury Department Order No. 101-5, it is ordered that:

the headquarters office of the Internal Revenue District for the State of Nevada be transferred from Reno, Nevada, to Las Vegas, Nevada; and

the Internal Revenue District for the State of Nevada be known as the Las Vegas Internal Revenue District.

1. *Las Vegas District:* Shall include the State of Nevada, with the headquarters office located in Las Vegas, Nevada.

2. *District Director of Internal Revenue:* The title of the District office shall bear the title "District Director of Internal Revenue," identified by the name of the city or subdivision thereof, in which the headquarters office is located.

3. *Implementation:* The provisions of paragraphs numbered 1-2 of this order shall be implemented upon such date as the Commissioner of Internal Revenue may determine. Effective immediately, the Commissioner of Internal Revenue is authorized to effect, at appropriate times and in an orderly manner, such transfers of functions, personnel, positions, equipment, and funds as may be necessary to implement the provisions of this Order.

4. *Effect on Prior Department of the Treasury Orders:* Paragraph 4(d) of Treasury Order 150-20, dated November 21, 1952 is superseded.

R.T. McNamar,
Deputy Secretary
of the Treasury.

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The "Proposed regulations" heading in the index contains a list of Code sections affected, the subject matter, and the "LR" or "EE" number and page.

Notice of Proposed Rulemaking

Treatment of Funded Welfare Benefit Plans

EE-66-84

SUMMARY: * * * [T]he Internal Revenue Service is issuing temporary regulations relating to contributions to and reserves of welfare benefit funds maintained pursuant to a collective bargaining agreement. The text of those temporary regulations also serves as the comment document for this notice of proposed rulemaking.

DATES: Written comments and requests for a public hearing must be delivered or mailed by September 3, 1985. The regulations are proposed to be effective for contributions paid or accrued after December 31, 1985.

ADDRESS: Send comments and requests for a public hearing to Commissioner of Internal Revenue, Attn: CC:LR:T (EE-66-84), 1111 Constitution Ave., N.W., Washington, D.C. 20224. FOR FURTHER INFORMATION CONTACT: John T. Ricotta of the Employee Plans and Exempt Organizations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224, Attention: CC:LR:T (EE-66-84), telephone: 202-566-4396 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

The temporary regulations provide guidance concerning the limits on contributions to and the reserves of welfare benefit funds maintained pursuant to a collective bargaining agreement under section 419A(f)(5) of the Internal Revenue Code of 1954 (Code), as added to the Code by section 511 of the Tax Reform Act of 1984 (26 U.S.C. §419A) [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1, 362]. The proposed regulations are issued under the authority contained in section 7805 of the Code (26 U.S.C. §7805). For the text of the temporary regulations, see F.R. Doc. [85-15940] published * * * [on page 146, this Bulletin].

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting the temporary regulations referred to in this document as final regulations, consideration will be given to any written comments that are submitted (preferably 8 copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

M. EDDIE HEIRONIMUS,
Acting Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on July 1, 1985, 8:45 a.m., and published in the issue of the Federal Register for July 3, 1985, 50 F.R. 27456)

Notice of Proposed Rulemaking

Effective Dates, Transitional Rules, Restrictions on Plan Distributions, and Other Issues Under the Retirement Equity Act of 1984

EE-3-85

SUMMARY: * * * [T]he Internal Revenue Service is issuing temporary regulations relating to effective dates, transitional rules, restrictions on distributions from employee plans and other issues arising under the Retirement Equity Act of 1984 [Pub. L. 98-397, 1984-2 C.B. 433]. The text of those temporary regulations also serves as the text for this Notice of Proposed Rulemaking.

DATES: Written comments and requests for a public hearing must be delivered or mailed before September 17, 1985. The amendments to the regulations generally would apply to plan years beginning after December 31, 1984, except as otherwise specified in the Retirement Equity Act of 1984, and are proposed be effective on the date of their publication in the Federal Register as a Treasury decision.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (EE-3-85), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles M. Watkins of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (EE-3-85), 202-566-3903 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

The temporary regulations * * * [on page 130, this Bulletin] amend 26 CFR by adding new sections under Part 1 to provide guidance so taxpayers can comply with Titles II and III of the Retirement Equity Act of 1984. The final regulations which are proposed to be based on the temporary regulations would amend Part 1 of Title 26 of the Code of Federal Regulations by adding similar sections to Part 1 (Income Tax; Taxable years beginning after December 31, 1953). The regulations are proposed to be issued under the authority contained in section 7805 of the Code (68A Stat. 917, 26 U.S.C. 7805). For the text of the temporary regulations, see F.R. Doc. 85-17238 (T.D. 8038) published * * * [on page 130, this Bulletin].

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although this document is a notice of proposed rulemaking which

solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

COMMENTS AND REQUEST FOR PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably 8 copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who submits written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

DRAFTING INFORMATION

The principal authors of these proposed regulations are Charles M. Watkins and William D. Gibbs of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

JAMES I. OWENS,
Acting Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on July 18, 1985, 8:45 a.m., and published in the issue of the Federal Register for July 19, 1985, 50 F.R. 29436)

Notice of Proposed Rulemaking

Notice, Election, and Consent Rules Under the Retirement Equity Act of 1984

EE-35-85

SUMMARY: * * * [T]he Internal Revenue Service is issuing temporary regulations relating to notice, election, and consent rules under the Retirement Equity Act of 1984 [Pub. L. 98-397, 1984-2 C.B. 433]. The text of those temporary regulations also serves as the text for this Notice of Proposed Rulemaking.

DATES: Written comments and requests for a public hearing must be delivered or mailed before September 17, 1985. The amendments to the regulations generally would apply to plan years beginning after December 31, 1984, except as otherwise specified in the Retirement Equity Act of 1984, and are proposed to be effective on the date of their publication in the Federal Register as a Treasury decision.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (EE-35-85), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles M. Watkins of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (EE-35-85), 202-566-3903 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

The temporary regulations * * * [on page 127, this Bulletin] amend 26 CFR by amending §1.401(a)-11T and and by adding a new section 1.402(f)-1T under Part 1 to provide guidance so taxpayers can comply with Titles II and III of the Retirement Equity Act of 1984. The final regulations which are proposed to be based on the temporary regulations would amend Part 1 of Title 26 of the Code of Federal Regulations by adding similar sections to Part 1 (Income Tax; Taxable years beginning after December 31, 1953). The regulations are proposed to be issued under the authority contained in section 7805 of the Code (68A Stat. 917, 26 U.S.C. 7805). For the text of the temporary regulations, see F.R. Doc. 85-17237 (T.D. 8037) published * * * [on page 127, this Bulletin].

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

COMMENTS AND REQUEST FOR PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably 8 copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER. The collection of information requirements contained herein have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on the requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for the Internal Revenue Service, New Executive Office Building, Washington D.C. 20503. The Internal Revenue Service requests persons submitting comments to OMB also to send copies of the comments to the Service.

DRAFTING INFORMATION

The principal authors of these proposed regulations are Charles M. Watkins and William D. Gibbs of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations both on matters of substance and style.

* * * * * *

JAMES I. OWENS,
Acting Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on July 18, 1985, 8:45 a.m., and published in the issue of the Federal Register for July 19, 1985, 50 F.R. 29436)

Withdrawal of Notice of Proposed Rulemaking

Front-End Tertiary Oil Under The Crude Oil Windfall Profit Tax Act of 1980

LR-68-80

SUMMARY: This document withdraws the notice of proposed rulemaking relating to the treatment of front-end tertiary oil under the Crude Oil Windfall profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B.I.] that was published in the FEDERAL REGISTER for December 5, 1980 (45 FR 80551).

FOR FURTHER INFORMATION CONTACT: David R. Haglund of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3297).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document withdraws the notice of proposed rulemaking that was published in the FEDERAL REGISTER for December 5, 1980 (45 FR 80551). That notice contained proposed amendments (§51.4994-2) to the Excise Tax Regulations (26 CFR Part 51) under section 4994(c) of the Internal Revenue Code of 1954. The regulations related to the treatment of front-end oil under the Crude Oil Windfall Profit Tax Act of 1980. A number of comments were received concerning the notice and a public hearing was held on February 24, 1981. Due to the fact that the front-end oil exemption expired on September 30, 1981, and the limited applicability of the proposed rules, it has been determined that such notice should be withdrawn. However, no inference should be drawn with respect to the positions taken in the proposed regulations because of the withdrawal of the notice.

DRAFTING INFORMATION

The principal author of this document is David R. Haglund of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing this document, both in matters of substance and style.

Withdrawal of Proposed Amendments

The proposed amendments to 26 CFR Part 51 relating to the treatment of front-end oil tertiary oil under the Crude Oil Windfall Profit Tax Act of 1980 published in the FEDERAL REGISTER for December 5, 1980 (45 FR 80551), are hereby withdrawn.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue

(Filed by the Office of the Federal Register on July 3, 1985, 8:45 a.m., and published in the issue of the Federal Register for July 5, 1985, 50 F.R. 27621)

Notice of Proposed Rulemaking

Residential Energy Credit

LR-73-80

SUMMARY: This document contains proposed regulations under section 23 of the Internal Revenue Code relating to the residential energy credit. Changes to the applicable tax law were made by the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 1]. These regulations would provide the public with the guidance needed to comply with the law.

DATES:

PROPOSED EFFECTIVE DATE

The proposed redesignations, revisions and amendments would be effective for taxable years beginning after December 31, 1983, except as follows:

Proposed Effective Date	
For expenditures made after April 19, 1977	Revision of the second sentence in paragraph (d)(2)(i) of §1.44C-1. Amendments to redesignated paragraph (d)(4)(ii) of §1.44C-1.
For expenditures made after April 19, 1977, in taxable years beginning before January 1, 1980	Revision within example (2) in paragraph (h)(4) of §1.44aC-3.
For expenditures made after December 31, 1979	Addition of a new sentence at the beginning of the flush material in paragraph (b)(2) of §1.44C-2. Amendment to the flush material in paragraph (e)(1)(iii) of §1.44C-2. Amendment to the first sentence of paragraph (e)(2) of §1.44C-2. Amendment to paragraph (d)(4)(iv) of §1.44C-2. Revisions in paragraph (f)(1) of §1.44C-2. Revisions of paragraph (f)(3)(i) and (ii) of §1.44C-2. Revision and addition within paragraph (f)(4) of §1.44C-2. Amendments to paragraphs (g) and (h) of §1.44C-2. Revisions of the heading and text of paragraph (j)(1) of §1.44C-3.
For taxable years beginning after December 31, 1979	Revision of paragraph (c) of §1.44C-1.
For taxable years beginning after December 31, 1980	Redesignation of and within paragraph (d)(3) and addition of a new paragraph (d)(3) to §1.44C-1. Amendment to the first sentence of paragraph (e) of §1.44C-1, concerning the reference to paragraph (d)(3). Addition of a new paragraph (i) to §1.44C-2. Revision of paragraph (c) of §1.44C-3.
Upon publication in the FEDERAL REGISTER of final rules.	Amendment in paragraph (f)(2) of §1.44C-2. Addition of a new paragraph (f)(3)(iii) to §1.44C-2. Addition of text to §1.44C-4. Amendment to paragraph (b)(1) of §1.44C-5.

DATE FOR COMMENTS AND REQUESTS FOR A PUBLIC HEARING Written comments and requests for a public hearing must be delivered or mailed by December 30, 1985.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-73-80), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Beverly A. Baughman of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T). (202-566-3297, not a toll-free number.)

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 23 (former section 44C) of the Internal Revenue Code of 1954, as amended (under its former designation) by sections 201(a), 202, and 203 of the Crude Oil Windfall Profit Tax Act of 1980 (Pub. L. 96-223, 94 Stat. 256) [1980-3 C.B. 1, 28, 30] and section 471 of the Tax Reform Act of 1984 (Pub. L. 98-369, 98 Stat. 826) [1984-3 C.B. (Vol. 1) 1, 333].

EXPLANATION OF PROVISIONS

Under section 23 a credit against Federal income tax is allowed for "qualified energy conservation expenditures" and "qualified renewable energy source expenditures."

Proposed §1.23-1(c) reflects the statutory increase of the credit for renewable energy expenditures to 40 percent of up to $10,000 of expenditures, for a maximum credit of $4,000. However, under proposed §1.23-1(d)(3), expenditures financed with subsidized energy financing are not taken into account in computing the credit except to reduce the maximum amount of allowable expenditures.

Proposed §1.23-2(b) expands the definition of the term "renewable energy source expenditures." Certain expenditures for an onsite well drilled for any geothermal deposit are treated as renewable energy source expenditures, but only if the taxpayer has not elected under section 263(c) to deduct any portion of such expenditures.

Proposed §1.23-2(f) expands the definition of the term "solar energy property" (a category of "renewable energy source property") to include systems that use solar energy to produce electricity. Additionally, certain solar roof panels, although structural components of the buildings in which they are installed, are treated as renewable energy source property. Proposed §1.23-2(f)(3) clarifies that certain systems utilizing thermal siphon principles are passive solar systems rather than active solar systems.

Proposed §1.23-2(i) provides a definition for the term "subsidized energy financing." An example in the definition clarifies the fact that the term subsidized energy financing includes subsidized financing under a Federal, State, or local program having two or more principal purposes, provided that at least one of the principal purposes is to provide subsidized financing to projects designed to conserve or produce energy.

Proposed §1.23-3(j) provides rules relating to jointly owned energy conservation property or renewable energy source property.

The proposed regulations would amend §1.23-4, previously reserved, to provide the performance and quality standards that must be met in order for certain items to qualify for the residential energy credit.

The performance and quality standards listed in these regulations contain standards for energy conserving components which are identical to the Department of Energy's standards for the Residential Conservation Service Program appearing in 10 CFR Part 456, subpart H.

The solar energy property standards listed in these regulations meet the applicable specific criteria of the National Bureau of Standards Building Science Series 147, Performance Criteria for Solar Energy Heating and Cooling Systems in Residential Buildings (September 1982).

COMMENTS AND REQUESTS FOR A HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held on written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

SPECIAL ANALYSIS

The Commissioner of Internal Revenue has determined that these proposed rules are not subject to review under Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required. Although this document is a notice of proposed rulemaking that solicits its public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of these regulations is Beverly A. Baughman of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Proposed amendments to the regulations

The proposed amendments to 26 CFR Parts 1 and 601 are as follows:

INCOME TAX REGULATIONS (26 CFR Part 1)

Paragraph 1. These regulations are issued under the authority of 26 U.S.C. 7805 and 226 U.S.C. 23. The authority citation for Part 1 is amended by adding at the end thereof "§1.23-1-§1.223-6 also issued under 26 U.S.C. 23."

Par. 2. §1.44C-1 is redesignated as §1.23-1 and is amended as follows:

1. Paragraph 9a) is amended—

1. By removing from the first sentence "Section 44C" and adding in its place the words "Section 23 or former section 44C",

2. By removing from the third sentence "§1.44C-3" and adding in its place "§1.23-3", and

3. By removing from the seventh sentence "§1.44C-3(h)" and adding in its place "§1.23-3(h)".

. 2. Paragraph (b) is amended by removing from the last sentence

"§1.44C-2(a)" and adding in its place "§1.23-2(a)".

3. Paragraph (c) is revised to read as set forth below.

4. Paragraph (d) is amended—

1. By removing from the first sentence of paragraph (d)(2)(i) "§1.44C-3(h)" and adding in its place "§1.23-3(h)",

2. By revising the second sentence of paragraph (d)(2)(i) to read as set forth below,

3. By removing from the last sentence of paragraph (d)(2)(ii) "§1.44C-3(h)" and adding in its place "§1.23-3(h)",

4. By redesignating paragraph (d)(3)(i), (ii), (iii), (iv), (v), (vi), (vii), (viii), (ix), and (x) as paragraph (d)(4)(ii)(A), (B), (C), (D), (E), (F), (G), (H), (I), and (J), respectively, and by inserting a new paragraph (d)(3) after paragraph (d)(2) to read as set forth below,

5. By inserting a new paragraph (d)(4)(i) after new paragraph (d)(3) to read as set forth below,

6. By removing from the heading of redesignated paragraph (d)(4)(ii) the words *"Tax Liability Limitation."* and adding in their place *"For taxable years beginning before January 1, 1984."*, and

7. In redesignated paragraph (d)(4)(ii), by removing the first word, "The", and adding in its place the words "For taxable years beginning before January 1, 1984, the".

5. Paragraph (e) is amended—

1. By removing from the heading the word "Carryover" and adding in its place the word "Carryforward",

2. By removing from the first sentence "section 44C(b)(5)" and adding in its place "section 23(b)(5) (or former section 44C(b)(5))",

3. By removing from the first sentence "paragraph (d)(3)" and adding in its place "paragraph (d)(4)", and

4. by removing the words "carryover" and "carried over" wherever they appear and adding in their place the words "carryforward" and "carried forward", respectively.

§1.23-1 Residential energy credit.

* * * * *

(c) *Qualified renewable energy source expenditures.* In the case of any dwelling unit, the qualified renewable energy source expenditures for taxable years beginning after December 31, 1979, and before January 1, 1986, are 40 percent of the renewable energy source expenditures made by the taxpayer during the taxable year with respect to such unit that do not exceed $10,000. In the case of taxable years beginning before January 1, 1980, the qualified renewable energy source expenditures are the renewable energy source expenditures made by the taxpayer with respect to the dwelling unit during the taxable year, but not in excess of—

(1) 30 percent of the expenditures up to $2,000, plus

(2) 20 percent of the expenditures over $2,000, but not more than $10,000.

See §1.23-2(b) for the definition of renewable energy source expenditures.

(d) *Limitation.* * * *

(2) *Prior expenditures taken into account*—(i) *In general.* * * * In the case of expenditures made during taxable years beginning before January 1, 1980, the reduction of the maximum amount under paragraph (c) must first be made with respect to the first $2,000 of expenditures (to which a 30 percent rate applies) and then with respect to the next $8,000 of expenditures (to which a 20 percent rate applies). * * *

* * * * *

(3) *Effects of grants and subsidized energy financing*—(i) *In general.* Qualified expenditures financed with Federal, State, or other grants shall be taken into account for purposes of computing the residential energy credit only if the amount of such grants is taxable as gross income to the taxpayer under section 61 (relating to the definition of gross income) and the regulations thereunder. In the case of taxable years beginning after December 31, 1980, qualified expenditures shall not be taken into account for purposes of computing the residential energy credit (except as provided in the following sentence) if made from subsidized energy financing (as defined in §1.23-2(i)). In addition, the taxpayer must reduce the maximum amount of allowable expenditures (reduced as provided in paragraph (d)(2) of this section) with respect to the dwelling unit in computing qualified energy conservation expenditures (under paragraph (b) of this section) or qualified renewable energy source expenditures (under paragraph (c) of this section), whichever is appropriate, by an amount equal to the sum of—

(A) The amount of the expenditures from subsidized energy financing (as defined in §1.23-2(i)) which were made by the taxpayer during the taxable year or any prior taxable year beginning after December 31, 1980, with respect to the same dwelling unit, and

(B) The amount of any funds received by the taxpayer during the taxable year or any prior taxable year as a Federal, State, or local government grant, made after December 31, 1980, which were used to make qualified expenditures with respect to the same dwelling unit and which were not included in the gross income of the taxpayer.

(ii) *Example.* The provisions of this paragraph (d)(3) may be illustrated by the following example:

Example. A had in 1979 made a renewable energy source expenditure of $2,000 in connection with A's residence for which he took the then allowed credit of $600. In 1981 A made additional renewable energy source expenditures of $9,000 with respect to which he received a loan of $5,000 from the Federal Solar-Energy and Energy Conservation Bank. Assume that the loan is subsidized energy financing. A computes the credit as follows: The initial maximum allowable dollar limit is $10,000 which is reduced by the sum of the prior year expenditures of $2,000 and the subsidized energy financing loan of $5,000 leaving a dollar limit of $3,000 ($10,000–($2,000 + 5,000)). The $5,000 portion of the $9,000 funded by the subsidized energy financing loan is not allowed as a renewable energy source expenditure. The remaining expenditures in 1981 are $4,000 ($9,000–$5,000). However, this amount exceeds the allowed maximum dollar limit of $3,000. Therefore, A's creditable expenses for 1981 are only $3,000 on which the credit is $1,200 (40 percent of $3,000).

(4) *Tax liability limitation*—(i) *For taxable years beginning after December 31, 1983.* For taxable years beginning after December 31, 1983, the credit allowed by this section shall not exceed the amount of tax imposed by chapter 1 of the Internal Revenue Code of 1954 for the taxable year, reduced by the sum of credits allowable under—

(A) Section 21 (relating to expenses for household and dependent care services necessary for gainful employment),

(B) Section 22 (relating to credit for

the elderly and the permanently and totally disabled), and

(C) Section 24 (relating to contributions to candidates for public office).

See section 26(b) and (c) for certain taxes that are not treated as imposed by chapter 1.

* * * * *

Par. 3. Section 1.44C-2 is redesignated as §1.23-2 and is amended as follows:

1. In the first sentence, the language "section 44C" is removed and the language "section 23 or former section 44C" is added in its place.

2. Paragraph (a) thereof is amended—

1. By removing from the last sentence of paragraph (a)(1)(i) "§1.44C-3(e)" and adding in its place "§1.23-3(e)", and

2. By removing from the second sentence of paragraph (a)(1)(iii) "§1.44C-3(f)" and adding in its place "§1.23-3(f)".

3. Paragraph (b) is amended—

1. By removing from the last sentence of paragraph (b)(1) "§1.44C-3(e)" and adding in its place "§1.23-3(e)", and

2. By adding a new sentence as flush material immediately before the flush material that follows paragraph (b)(2), to read as set forth below.

4. Paragraph (c)(4) is amended by removing from the first sentence "§1.44C-4" and adding in its place "§1.23-4".

5. Paragraph (d) is amended—

1. By removing from paragraph (d)(3) "§1.44C-4" and adding in its place "§1.23-4",

2. By removing from the first sentence of paragraph (d)(4)(iv) the word "include" and adding in its place the word "mean", and

3. By removing from the last sentence of paragraph (d)(4)(viii) "§1.44C-6" and adding in its place "§1.23-6".

6. Paragraph (e) is amended—

1. By removing from paragraph (e)(1)(iii) "§1.44C-4" and adding in its place "§1.23-4",

2. By removing the first sentence from the flush material immediately following paragraph (e)(1)(iii) and adding in its place a new sentence to read as set forth below,

3. By removing "§1.44C-3(l)" from the last sentence in the flush material following paragraph (e)(1)(iii) and adding in its place "§1.23-3(l)",

4. By adding in paragraph (e)(2) the words "or (in the case of expenditures made after December 31, 1979) electricity" immediately following the words "or providing hot water" in the first sentence, and

5. By removing from the last sentence of paragraph (e)(2) "§1.44C-6" and adding in its place "§1.23-6".

7. Paragraph (f) is amended—

1. By revising the first and third sentences of paragraph (f)(11) to read as set forth below,

2. By removing the first sentence of paragraph (f)(2) and adding in its place a new sentence to read as set forth below,

3. By revising paragraph (f)(3) to read as set forth below, and

4. By revising the third sentence of paragraph (f)(4) and adding two new sentences immediately after that sentence, to read as set forth below.

8. Paragraph (g) is amended by removing from the beginning of the first sentence the word "includes" and adding in its place the word "means".

9. paragraph (h) is amended by removing from the first sentence the word "includes" and adding in its place the word "means" and by adding a new sentence immediately after the first sentence to read as set forth below.

10. A new paragraph (i) is added immediately after paragraph (h) to read as set forth below.

§1.23-2 Definitions.

* * * * *

(b) *Renewable energy source expenditures.** * * Additionally, the term "renewable energy source expenditures" includes expenditures made after December 31, 1979, and before January 1, 1986, for an onsite well drilled for any geothermal deposit (as defined in paragraph (h)), or for labor costs properly allocable to onsite preparation, assembly, or original installation of such well, but only if the requirements of paragraph (b)(1) and (2) of this section are met and the taxpayer has not elected under section 263(c) to deduct any portion of such expenditures or allocable labor costs.

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(e) *Renewable energy source property*—(1) *In general.** * *

(iii) * * * Renewable energy source property does not include heating or cooling systems, nor systems to provide hot water or electricity, which serve to supplement renewable energy source equipment in heating, cooling, or providing hot water or electricity to a dwelling unit, and which employ a form of energy (such as oil or gas) other than solar, wind, or geothermal energy (or other forms of renewable energy provided in paragraph (e)(2) of this section).* * *

(f) *Solar energy property*—(1) *In general.* The term "solar energy property" means equipment and materials of a solar energy system as defined in this paragraph (and parts solely related to the functioning of such equipment) which, when installed in connection with a dwelling, transmits or uses solar energy to heat or cool the dwelling or to provide hot water or (in the case of expenditures made after December 31, 1979) electricity for use within the dwelling.* * * Property which uses, as an energy source, fuel or energy which is indirectly derived from sunlight (solar radiation), such as fossil fuel or wood or heat in underground water, is not considered solar energy property.* * *

(2) *Active solar system.* With respect to solar energy property acquired after the date of publication in the Federal Register of a Treasury decision promulgating this amended paragraph (f)(2) as a final regulation, an active solar system is based on the use of mechanically forced energy transfer, such as the use of fans or pumps to circulate solar generated energy.* * *

(3) *Passive solar system*—(i) *In general.* A passive solar system is based on the use of conductive, convective, or radiant energy transfer.

(ii) *Passive solar space heating system.* In order to qualify as a passive solar system, a solar system used for space heating purposes must contain all of the following: a solar collection area, an absorber, a storage mass, a heat distribution method, and heat regulation devices. The term "solar collection area" means an expanse of transparent or translucent material, such as

glass which is positioned in such a manner that the rays of the sun directly strike an absorber. The term "absorber" means a surface, such as a floor, that is exposed to the rays of the sun admitted through the solar collection area, which converts solar radiation into heat, and then transfers the heat to a storage mass. The term "storage mass" means material, such as masonry, that receives and holds heat from the absorber and later releases the heat to the interior of the dwelling. The storage mass must be of sufficient volume, depth, and thermal energy capacity to store and deliver adequate amounts of solar heat for the relative size of the dwelling. In addition, the storage mass must be located so that it is capable of distributing the stored heat directly to the habitable areas of the dwelling through a heat distribution method. The term "heat distribution method" means the release of radiant heating from the storage mass within the habitable areas of the dwelling, or convective heating from the storage mass through airflow paths provided by openings or by ducts in the storage mass, to habitable areas of the dwelling. The term "heat regulation devices" means shading or venting mechanisms (such as awnings or insulated drapes) to control the amount of solar heat admitted through the solar collection areas and nighttime insulation or its equivalent to control the amount of heat permitted to escape from the interior of the dwelling.

(iii) *Passive solar hot water system.* With respect to solar energy property acquired after the date of publication in the Federal Register of a Treasury decision promulgating this paragraph (f)(3)(iii) as a final regulation, the term "passive solar system" includes a system used to provide hot water for a dwelling which uses passive thermal energy transfer such as systems utilizing thermal siphon principles. Such a system is not required to have all of the components described in paragraph (f)(3)(ii) of this section.

(4) *Components with dual functions.* * * * For example, roof ponds that form part of a roof (including additional structural components to support the roof), windows (including clerestories and skylights), and greenhouses do not qualify as solar energy property. However, with respect to expenditures made after December 31, 1979, a solar collector panel installed as a roof or portion thereof (including additional structural components to support the roof attributable to the collector) does not fail to qualify as solar energy property solely because it constitutes a structural component of the dwelling on which it is installed. For this purpose, the term "solar collector panel" does not include a skylight or other type of window.* * *

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(h) *Geothermal energy property.* * * * With respect to expenditures made after December 31, 1979, the term "geothermal energy property" also means equipment (and parts solely related to the functioning of such equipment) necessary to transmit or use energy from a geothermal deposit to produce electricity for use within the dwelling.* * *

(i) *Subsidized energy financing*—(1) *In general.* The term "subsidized energy financing" means financing (*e.g.*, a loan) made directly or indirectly (such as in association with, or through the facilities of, a bank or other lender) during a taxable year beginning after December 31, 1980, under a Federal, State, or local program, a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy. For purposes of this paragraph (i), financing is made when funds that constitute subsidized energy financing are disbursed. Subsidized energy financing includes financing under a Federal, State, or local program having two or more principal purposes (provided that at least one of the principal purposes is to provide subsidized financing for projects designed to conserve or produce energy), but only to the extent that the financing—

(i) Is to be used for energy production or conservation purposes, or

(ii) Is provided out of funds designated specifically for energy production or conservation. Loan proceeds meet the use test of paragraph (i)(1)(i) of this section only to the extent that the loan application, the loan instrument, or any other loan-related documents indicate that the funds are intended for such use. However, loan proceeds designated for the purchase either of property that contains "insulation" or any "other energy conserving component" or of "renewable energy source property" as defined in paragraphs (c), (d), and (e), respectively, of this section meet the test of paragraph (i)(1)(i) of this section. Financing is subsidized if the interest rate or other terms of the financing (including any special tax treatment) provided to the taxpayer in connection with the program or used to raise funds for the program are more favorable than the terms generally available commercially. Additionally, financing is subsidized if the principal obligation of the financing provided to the taxpayer is reduced by funds provided under the program. Except as otherwise provided for in this paragraph (i)(1) with respect to a publicly or privately owned utility, the source from which the funds for the program are derived is not a factor to be taken into account in determining whether the financing is subsidized. If a publicly or privately owned utility disburses funds for the financing of renewable energy source property, and the source of the funds is sales to the utility's ratepayers, then the funds are not considered subsidized energy financing, even though the utility is a government agency. Subsidized energy financing does not include a grant includible in gross income under section 61, nontaxable grants, a credit against State or local taxes made directly to the taxpayer claiming the credit provided for in section 23, or a loan guarantee made directly to the taxpayer claiming the credit provided for in section 23.

(2) *Examples.* The provisions of this paragraph (i) may be illustrated by the following examples:

Example (1). State A has a farm and home loan program. The program is used to provide low interest mortgage loans. In 1984 State A's legislature enacted statutory amendments to its farm and home loan program in an effort to encourage energy conservation-type measures. Low interest loans for such improvements were made available to qualified purchasers and owners under the farm and home loan program. The energy conservation measures subsidized by the program include energy conserving components and renewable energy source devices. State A's tax exempt bonds are the source of funds for loans under the program. Although the 1984 legislation authorizing loans for energy conserving components and renewable energy source improvements did not diminish the original purpose of the farm and home loan program, the 1984 legislation added another principal purpose to the program. Therefore, State A's program which has two principal purposes, one of which is the conserva-

tion or production of energy, is considered as providing subsidized energy financing for purposes of section 23(c)(10) of the Code, to the extent that financing is provided by State A out of funds designated specifically for energy production or conservation. State A's program will also be considered as providing subsidized energy financing to the extent that the loan proceeds are to be used for energy production or conservation purposes. Loan proceeds meet the use test of the preceding sentence only to the extent that the loan application, the loan instruments, or any other loan-related documents indicate that the funds are intended for such use.

Example (2). The United States Department of Energy disburses funds to State B that the Department received from settlements from alleged petroleum pricing and allocation violations. State B establishes a program under which B will use the funds to make loans at below market interest rates directly to qualified applicants for the purchase of renewable energy source property. B's loans are subsidized energy financing.

Example (3). State C establishes a program under which C will make loans at below market interest rates directly to qualified applicants for the purchase of renewable energy source property. The program is funded with money that State C was able to borrow after it obtained a loan guarantee from a Federal agency. C's loans provided under the program are subsidized energy financing.

Example (4). Company D is electric utility that is a federal agency. D purchases its electricity from another federal agency, transmits the electricity over its own distribution system, and sells the electricity to numerous local public utilities that in turn sell the electricity to their customers. D wishes to start a program under which D will make loans at below market interest rates directly to customers of the local utilities for the purchase of renewable energy source property from D. The local public utility will act as the collection agent for repayment of the loans. The loans will be repayable over a period of time not in excess of 15 years. Under law, D must cover its full costs through its own revenues derived from the sale of power and other services. While D may borrow by sale of bonds to the United States Treasury, D must borrow at rates comparable to the rates prevailing in the market for similar bonds. Thus, the subsidized loans made under D's program will be financed by the profits from the sale of electricity to consumers and not by the federal government. D's program, which is substantially the same as that carried out by private (investor-owned) utilities, is not a tax-supported subsidy for renewable energy source property because the source of the funds for the loan program is solely D's revenue from the sale of electricity or D's unsubsidized borrowing from the United States Treasury at rates comparable to the rates prevailing in the market. Therefore, D's loans are not subsidized energy financing.

Example (5). The Solar Energy and Energy Conservation Bank (Bank) disburses funds to State E. E disburses a portion of the funds to Financial Institution F. Both the Bank and State E make these disbursements under a program the principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy. F uses the funds to reduce a portion of the principal obligation on loans it issues to finance energy conservation or solar energy expenditures. Taxpayer G borrows $3,000 from F in order to purchase a solar water heating system. F uses $500 of the funds it received from the Bank to reduce the principal obligation of the loan to G to $2,500. The amount of subsidized energy financing to G is $3,000.

Example (6). State H allows a tax credit to Financial Institution J under a program the principal purpose of which is to provide loans at below market interest rates directly to qualified applicants for the purchase of renewable energy source property. J receives a credit each year in the amount of the excess of the interest that would have been paid at private market rates over the actual interest paid on such loans. The State H tax credit arrangement is an interest subsidy. Thus, any low-interest loans made pursuant to this credit arrangements are subsidized energy financing.

Par. 4. Section 1.44C-3 is redesignated as §1.23-3 and is amended as follows:

1. Paragraph (a)(1) is amended by removing from the first sentence "section 44C" and adding in its place "section 23 or former section 44C".

2. Paragraph (b) is amended by removing "section 44C" in the first and second sentences and adding in place thereof "section 23 or former section 44C".

3. Paragraph (c) is revised to read as set forth below.

4. Paragraph (d) is amended by removing "§1.44C-2(a)", "§1.44C-2(b)", "§1.44C-1(b)", and "§1.44C-1(c)" and adding in their places "§1.23-2(a)" "§1.23-2(b)", "§1.23-1(b)" and "§1.23-1(c)", respectively.

5. Paragraph (e) is amended by removing from the first sentence "section 44C" and adding in its place "section 23 or former section 44C".

6. Paragraph (h) is amended—

1. By removing from the first sentences of paragraph (h)(1)(i) and (ii) "section 44C" and adding in place thereof "section 23 or former section 44C",

2. By removing from paragraph (h)(2) "section 44C" and adding in its place "section 23 or former section 44C",

3. By removing from paragraph (h)(2) "§1.44C-1" and adding in its place "§1.23-1",

4. By removing from the second sentence of paragraph (h)(3) "section 44C" and adding in its place "section 23 or former section 44C", and

5. By revising the first sentence of example (2) in paragraph (h)(4) to read as set forth below.

7. Paragraph (j) is amended—

1. By revising the heading and text of paragraph (j)(1) to read as set forth below, and

2. By removing from the last sentence of the example in paragraph (j)(2) "§1.44C-1(d)(1)" and "§1.44C-1(d)(2)" and adding in their places "§1.23-1(d)(1)" and "§1.23-1(d)(2)", respectively.

8. Paragraph (k) is amended by removing "section 44C" and adding in its place "section 23 or former section 44C".

§1.23-3 Special rules.

* * * * *

(c) *Cross reference.* For rules relating to expenditures financed with Federal, State, or local government grants or subsidized financing see paragraph (d)(3) of §1.23-1 and paragraph (i) of §1.23-2.

* * * * *

(h) *Joint occupancy.* * * *

(4) * * *

* * * * *

Example (2). In 1978, spouses C and D make $10,000 of renewable energy source expenditures with respect to their principal residence, half of which is paid by each spouse. * * *

* * * * *

(j) *Joint ownership of energy conservation property or renewable energy source property*—(1) *In general.* Energy conservation property and renewable energy source property include property which is jointly owned by the taxpayer and another person (or persons) and installed in connection with two or more dwelling units. For example, the fact that a windmill, solar collector, or geothermal well and distribution system is owned by two or more individuals does not preclude its qualification as renewable energy source property. The amount of the credit allowable under section 23 shall be computed separately with respect to the amount of the expenditures made by each individual, subject to the limitations of $2,000 imposed by section 23(b)(1) and $10,000 imposed by section 23(b)(2), per dwelling unit of jointly owned property. For example, in 1982, A, B, and C purchased as joint owners renewable energy source

property that serviced two houses. One of the houses is jointly owned and occupied by A and B and the other is owned and occupied by C alone. The renewable energy source property cost $30,000 of which A paid $9,000, B paid $6,000, and C paid $15,000. A and B must share the $4,000 credit (40% of $10,000 maximum) with respect to the expenditures for the jointly owned house. Therefore, a is allowed a $2,400 credit

and B is allowed a $1,600

$$(\$4{,}000 \times \frac{\$9{,}000}{\$9{,}000 + \$6{,}000})$$

with respect to the

$$(\$4{,}000 \times \frac{\$6{,}000}{\$9{,}000 + \$6{,}000})$$

expenditures attributable to the jointly owned house. C is entitled to a credit of $4,000 with respect to the expenditures attributable to the other house.

Par. 5. Reserved §1.44C-4 is redesignated §1.23-4 and the text is added to read as follows:

§1.23-4 Performance and quality standards

(a) *In general.* This section contains performance and quality standards with respect to energy-conserving components and solar energy property. Such an item acquired after the date of publication of this section in a Treasury decision must meet the standards, as in effect when the item is acquired, to qualify for the residential energy credit.

(b) *Energy-conserving components standards*—(1) *In general.* This paragraph provides standards with respect to insulation and certain other energy-conserving components. The standards are identical to the Department of Energy's standards for the Residential Conservation Service Program appearing in 10 CFR part 456, Subpart H. Paragraph (b)(2) of this section incorporates the applicable provisions of subpart H into this section by reference.

(2) *Incorporation by reference.* (i) Insulation (as defined in §1.23-2(c)) shall meet the applicable standards contained in §456.803-812.

(ii) A furnace replacement burner (as defined in §1.23-2(d)(4)(i)) for oil-fired furnaces shall meet the standards contained in §456.814(d).

(iii) A device for modifying flue openings (as defined in §1.23-(d)(4)(ii)) for gas-fired heating systems shall meet the standards contained in §456.814(g).

(iv) A furnace ignition system (as defined in §1.23-2(d)(4)(iii)) for gas-fired heating systems shall meet the standards contained in §456.814(f).

(v) A storm or thermal window or door (as defined in §1.23-2(d)(4)(iv)) shall meet the applicable standards contained in §456.813 Multi-glazing used in connection with a window or door shall meet the standards contained in §456.813(d).

(vi) Caulking (as defined in §1.23-2(d)(4)(vi)) shall meet the standards contained in §456.812.

(c) *Solar energy property standards.* Solar energy property shall meet the applicable specific criteria of the National Bureau of Standards Building Science Series 147, Performance Criteria for Solar Energy Heating and Cooling Systems in Residential Buildings (September 1982) as indicated in the table set forth below. In that table "A" refers to active solar systems for space heating or domestic hot water described in paragraph (f)(2) of §1.23-2. "P (ii)" refers to passive solar space heating systems and combined systems described in paragraph (f)(3)(ii) of §1.23-2. "P (iii)" refers to passive solar hot water systems utilizing thermal siphon principles. Manufacturers of equipment that meets the standards referred to in the table may apply for certification in accordance with the provisions of §1.23-5. If so certified, manufacturers may attach a decal, nameplate, or other marketing to their equipment so identifying their equipment.

		System type		
Criteria	Paragraph	A	P(ii)	P(iii)
Net solar contribution	2.1.1		x	
Thermal Storage	2.1.2		x	
Building overheating	2.1.3		x	
Technical cooling energy	2.1.4		x	
Thermal environment contribution	2.1.5		x	
Mechanical heating system size	2.2.1	x		
Temperature	2.3.1	x		x
Daily water use	2.3.2	x		x
Hourly recover use	2.3.3	x		x
Array manifold, energy loss	2.4.3	x		x
Heat loss during non-collection periods	2.4.4	x		
Thermal energy loss	2.5.1	x	x	
Thermal energy loss	2.6.1	x	x	x
Operating energy	2.6.2	x	x	
Energy transfer to load	2.6.4	x		x
Collector fluid circulation	2.7.2	x		
Priority of energy use	2.7.3	x	x	x
System balancing	3.1.2	x		
Liquid quality	3.2.3	x		x
Thermal expansion of fluids	3.2.4	x		x
Draining and filling	3.2.5	x		x
Entrapped air	3.2.6	x		x
Vacuum relief	3.2.7	x		x
Duct design	3.3.1	x	x	x
Sealing of air system	3.3.2	x	x	
Movable insulation	3.4.2		x	
Inhabited space temperature Control	3.5.1	x	x	
Power operated protection	3.6.3	x		
Freeze tolerant designs	3.6.4	x		x
Protection of potable water	4.1.1	x		x
Separation of circulation loops	4.1.2	x		x
Contamination of air	4.1.4	x	x	
Growth of fungi	4.1.5	x	x	x
Pressure and/or temperature relief devices	4.3.1	x		x
System failure prevention	4.3.2	x	x	x
Surface temperature	4.3.5	x	x	x
Liquid flash point	4.4.1	x		x
Fire resistance requirements	4.4.5	x	x	x
Roof covering fire performance	4.4.6	x		x
Structural resistance of system	4.6.1	x	x	x
Solar degradation	5.1.1	x	x	x
Thermal degradation	5.2.1	x	x	x
Installation instructions	6.1.1	x	x	x
Operation and Maintenance instructions	6.1.2	x	x	x
Normal operation by occupant	6.1.7	x	x	x
Minimum operating information	6.3.2	x		x

Par. 6. Section 1.44C-5 is redesignated as §1.23-5 and is amended as follows:

1. Paragraph (a) is amended—

1. By removing from paragraph (a)(1) "§1.44C-2(c)(1)" and adding in its place "§1.23-2 (c)(1)",

2. By removing from paragraph (a)(2) "section 44C(c)(4)" and adding in its place "section 23(c)(4) or former section 44C(c)(4)",

3. By removing from paragraph (a)(2) "§1.44C-2(d)(4)" and adding in its place "§1.23-2(d)(4)",

4. By removing from paragraph (a)(3) "§1.44C-2(f)", "1.44C-2(g)" and "§1.44C-2(h)" and adding in their places "§1.23-2(f)", "§1.23-2(g)", and "§1.23-2(h)", respectively,

5. By removing from paragraph (a)(4) "§1.44C-2" and adding in its place "§1.23-2", and

6. By removing from paragraph (a)(5) "§1.44C-2" and adding in its place "§1.23-2".

2. Paragraph (b)(1) is amended by removing from the first sentence the words "Assistant Commissioner (Technical), T:C:E, 1111 Constitution Avenue, N.W.," and adding in their place the words "Associate Chief Counsel (Technical) CC:C:E, 1111 Constitution Avenue, N.W.,"

3. Paragraph (c) is amended—

1. By removing from the third sentence "§1.44C-2" and adding in its place "§1.23-2", and

2. By removing from the last sentence "§1.44C-4" and adding in its place "§1.23-4".

Par. 7. Section 1.44C-6 is redesignated as §1.23-6 and is amended as follows:

1. Paragraph (a)(1) is amended by removing from the first sentence "§1.44C-2" and adding in its place "§1.23-2".

2. Paragraph (e) is amended—

1. By removing from the first sentence "§1.44C-1" and adding in its place "§1.23-1", and

2. By removing from the third sentence "§1.44C-4" and adding in its place "§1.23-4."

Par. 8. Paragraph (t) of §1.1016-5 is revised to read as follows:

§1.1016-5 Miscellaneous adjustments to basis.

* * * * *

(t) *Section 23 credit.* In the case of property with respect to which a credit has been allowed under section 23 or former section 44C (relating to residential energy credit), basis shall be adjusted as provided in paragraph (k) of §1.23-3.

STATEMENT OF PROCEDURAL RULES
(26 CFR Part 601)

Par. 9. The authority citation for Part 601 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 10. Paragraph (c) of §601.601 is amended by revising the last sentence to read as follows:

§601.601 Rules and regulations.

* * * * *

(c) *Petition to change rules.* * * * However, in the case of petitions to amend the regulations pursuant to subsection (c)(4)(A)(viii) or (5)(A)(i) of section 23 or former section 44C, follow the procedure outlined in paragraph (a) of §1.23-6.

ROSCOE L. EGGER, JR.,
Commissioner

(Filed by the Office of the Federal Register on October 30, 1985, 8:45 a.m., and published in the issue of the Federal Register for October 31, 1985, 50 F.R. 45423)

Notice of Proposed Rulemaking
Election to Expense Certain Depreciable Business Assets
LR-233-81

SUMMARY: This document contains proposed regulations relating to the election to expense certain depreciable business assets. Changes to the applicable tax law were made by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256], the Subchapter S Revision Act of 1982 [Pub. L. 97-448, 1983-1 C.B. 451], and the Tax Reform Act of 1984 (Division A of the Deficit Reduction Act of 1984) [1984-3 C.B. (Vol. 1) 1]. The regulations would provide the public with the guidance needed when making an election to expense certain depreciable business assets.

DATES: Written comments and requests for a public hearing must be delivered or mailed by November 11, 1985. Generally, the amendments are proposed to be effective for property placed in service after December 31, 1980, in taxable years ending after such date. The amendments made by the Subchapter S Revision Act of 1982 are proposed to be effective for taxable years beginning after December 31, 1982.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-233-81), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: John Broadbent of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, (202) 566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION:
BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 179, 263, 1033, and 1245 of the Internal Revenue Code of 1954 (Code). These amendments are proposed to reflect the amendments made by sections 202(a) and 209 of the Economic Recovery Tax Act of 1981 (Pub. L. 97-34, 95 Stat. 219, 226) [1981-2 C.B. 256, 282, 286], section 3(f) of the Subchapter S Revision Act of 1982 (Pub. L. 97-354, 96 Stat. 1689) [1982-2 C.B. 702, 712], section 102(aa) of the Technical Corrections Act of 1982 (Pub. L. 97-488, 96 Stat. 2369) [1983-1 C.B. 451, 453], and section 13 of the Tax Reform Act of 1984 (Pub. L. 98-369, 98 Stat. 505) [1984-3 C.B. (Vol.1) 1, 13] and are to be issued under the authority of Code sections 179(c), (d)(10) and 7805 (95 Stat. 219, 96 Stat. 2369, 68A Stat. 917; 26 U.S.C. 179(c), 179(d)(10), 7805).

IN GENERAL

Section 179, as amended by the Economic Recovery Tax Act of 1981, provides taxpayers (other than trusts, estates, and certain noncorporate lessors) with the opportunity to elect to expense the cost or portion of the cost of certain depreciable business assets rather than capitalizing the entire cost. A section 179 expense election may be made for

the taxable year in which the section 179 property" and "placed in service" are defined in proposed §§1.179-3(a) and (f).

DOLLAR LIMITATION

Proposed §1.179-2(a) provides rules relating to the maximum amount a taxpayer may elect to expense. Proposed §1.179-1(c) allows a taxpayer to claim the maximum amount allowed by §1.179-2(a) for any taxable year, without proration based on the period of time the section 179 property has been in service during the taxable year. Proposed §1.179-2(e)(2) provides rules for where spouses file separate returns and then subsequently file a joint return. Under proposed §1.179-2(f), the maximum amount a married taxpayer filing a separate return may elect to expense is 50 percent of the amount determined under proposed §1.179-2(a).

CONTROLLED GROUPS

Rules for allocating the dollar limitation among component members of a controlled group of corporations are set forth in proposed §1.179-2(b). Component members are treated as one taxpayer in applying the dollar limitation. The dollar amount may be allocated to the members of the group by the common parent corporation if a consolidated return is filed; if separate returns are filed, the amount is to be allocated in accordance with an agreement made by the members. The definition of the term "controlled group of corporations" in section 1563(a) applies for purposes of section 179 by substituting "more than 50 percent" for the phrase "at least 80 percent" wherever it appears in section 1563(a)(1).

PARTNERSHIPS AND S CORPORATIONS

Proposed §1.179-2(c) provides that the dollar limitation of section 179(b) applies to both the partnership and each individual partner. Under proposed §1.179-2(c)(2), a partner's share of the partnership's section 179 expense is to be determined in accordance with section 704 and the regulations thereunder. Proposed §1.179-2(d) provides that similar rules apply to S corporations and their shareholders.

ADJUSTMENTS TO BASIS

Proposed §§1.179-1(f) and (g) provide that if a taxpayer elects section 179, the taxpayer must adjust the basis of the section 179 property prior to computing the deduction under section 168 or the investment credit under section 38. However, no such basis reduction is made for a section 179 expense deduction that is allocable by a partnership or S corporation to a partner or shareholder that is a trust or estate.

CHANGES IN USE; RECAPTURE

Section 179(d)(10) provides for recapture of any tax benefits derived from expensing under section 179 where, at any time prior to the close of the second taxable year following the taxable year in which the property is placed in service (recapture period), the property is not used predominantly in the taxpayer's trade or business. Proposed §1.179-1(e)(1) provides that the amount recaptured is equal to the excess of the amount expensed under section 179 over the total amount that would have been allowable for prior taxable years and the taxable year of recapture as a deduction under section 168 (had section 179 not been elected) for the portion of the cost of the property to which the expensing relates. The amount recaptured shall be treated as ordinary income for the taxable year in which the property is no longer used predominantly in the taxpayer's trade or business. Proposed §1.179-1(e)(2) provides that property will be treated as not predominantly used isn the taxpayer's trade or business if 50 percent or more of the use of such property during any taxable year within the recapture period is for a use other than in the taxpayer's trade or business. In addition, if, during any taxable year of the recapture period, the taxpayer disposes of the property (other than in a disposition to which section 1245(a) applies) or ceases to use the property in a trade or business in a manner that had the taxpayer claimed a credit under section 38 for such property such disposition or cessation in use would cause recapture under section 47, the property will be treated as not used predominantly in a trade or business of the taxpayer. However, for purposes of applying the recapture rules of section 47 pursuant to the preceding sentence, converting the use of the property from use in a trade or business to use in the production of income will be treated as a conversion to personal use.

SECTION 280F

Section 280F places limitations on the amount that may be expensed with respect to certain items of section 179 property. In addition, proposed §1.179-1(e)(1) provides that if the recapture rules of both section 280F-(b)(3) and §1.179-1(e)(1) apply to an item of section 179 property, the amount of recapture shall be detemined only under the rules of section 280F(b)(3) with respect to such property.

ELECTION

Proposed §1.179-4(a) provides rules relating to the time and manner of making a section 179 election. In addition, the regulations provide that the amount of the expense elected and the properties chosen must be specified on the taxpayer's tax return. Proposed §1.179-4(b) provides rules relating to the revocation fo the election under section 179 and to the changing of property selected for the section 179 expense.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although this document is a notice of a proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a

public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Office for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

DRAFTING INFORMATION

The principal author of these proposed regulations is Neil W. Zyskind of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

* * * * *

Proposed amendments to the regulations

The proposed amendments to 26 CFR Part 1 are as follows:

Paragraph 1. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805. * * * Section 1.179-1 also issued under 26 U.S.C. 179(d). Section 1.179-4 also issued under 26 U.S.C. 179(c). * * *

Par. 2. Sections 1.179-1 through 1.179-4 are revised to read as set forth below.

§1.179-1 Election to expense certain depreciable assets.

(a) *In general.* Section 179 allows a taxpayer to elect to expense the cost (as defined in §1.179-3(e)), or portion of the cost, of section 179 property (as defined in §1.179-3(a)) for the taxable year in which the property is placed in service (as defined in §1.179-3(f)). The election is not available for trusts, estates, and certain noncorporate lessors. See paragraph (i)(2) of this section relating to noncorporate lessors.

(b) *Amount subject to expense.* The expense deduction under section 179 is allowed for the entire cost or a portion of the cost of one item of section 179 property, or the entire cost or a portion of the cost of several items of section 179 property, subject to the dollar limitation of section 179(b) and §1.179-2. The properties and apportionment of cost to be subject to the election shall be selected by the taxpayer.

(c) *Proration not required.* The expense deduction under section 179 is determined without any proration based on the period of time the section 179 property has been in service during the taxable year. For example, a taxpayer, a corporation which files its income tax returns on the calendar year basis, purchases and places in service on December 1, 1983, section 179 property costing $10,000. The corporation may elect to claim a section 179 expense deduction for the taxable year ending December 31, 1983, for the cost of the property (up to the $5,000 limitation imposed under section 179(b)(1)) without proration for the number of days in 1983 during which the property was in service.

(d) *Partial business use.* If a taxpayer uses section 179 property for both trade or business and non-trade or business purposes, the portion of the cost of the property attributable to the trade or business use is eligible for expensing under section 179, provided that more than 50 percent of the property's use in the taxable year the property is placed in service is for trade or business purposes. The dollar limitation of section 179(b) is then applied to the portion of the cost attributable to the trade or business use. For example, a taxpayer in 1983 purchases section 179 property costing $10,000 for which 80 percent of its use will be in the taxpayer's trade or business. The cost of the property, adjusted to reflect the business use of the property, is $8,000 (80 percent x $10,000). Thus, the taxpayer could elect to expense up to $5,000 of the cost of the property (see section 179(b)). However, for property placed in service after June 18, 1984, in taxable years ending after such date, see section 280F(d)(1) relating to the coordination of section 179 with the limitation on the amount of depreciation and investment tax credit for luxury automobiles and where certain property is used for personal purposes. Furthermore, see paragraphs (e)(1) through (3) of this section relating to recapture where the property is no longer predominantly used in the taxpayer's trade or business.

(e) *Change in use; recapture*—(1) *In general.* If a taxpayer's section 179 property is not used predominantly in a trade or business of the taxpayer at any time before the close of the second taxable year following the taxable year in which the property is placed in service by the taxpayer (recapture period), the taxpayer must recapture in the taxable year in which the section 179 property is not used predominantly in a trade or business any benefit derived from expensing such property. The benefit derived from expensing the property is equal to the excess of the amount expensed under this section over the total amount that would have been allowable for prior taxable years and the taxable year of recapture as a deduction under section 168 (had section 179 not been elected) for the portion of the cost of the property to which the expensing relates (regardless of whether such excess reduced the taxpayer's tax liability). For purposes of the preceding sentence, in the case of an individual who does not elect to itemize deductions under section 63(g) in the taxable year of recapture, the amount allowable as a deduction under section 168 in the taxable year of recapture shall be determined by treating property used in the production of income other than rents or royalties as being property used for personal purposes. The amount to be recaptured shall be treated as ordinary income for the taxable year in which the property is no longer used predominantly in a trade or business of the taxpayer. For taxable years following the year of recapture, the taxpayer's deductions under section 168(a) shall be determined as if no section 179 election with respect to the property had been made. However, for property placed in service after June 18, 1984, in taxable years ending after such date, see section 280(f)(d)(1) relating to the coordination of section 179 with the limitation on the amount of depreciation and investment tax credit for luxury automobiles and where certain

perty is used for personal purposes. he recpture rules of both section F(b)(3) and this paragraph (e)(1) ly to an item of section 179 prop-, the amount of recapture shall be rmined only under the rules of sec- 280F(b)(3) with respect to such perty.

2) *Predominant use.* Property will reated as not used predominantly in ade or business of the taxpayer if 50 cent or more of the use of such perty during any taxable year within recapture period is for a use other in a trade or business of the tax- er. If during any taxable year of the pture period the taxpayer disposes he property (other than in a disposi- to which section 1245(a) applies) eases to use the property in a trade usiness in a manner that had the ayer claimed a credit under section or such property such disposition or ation in use would cause recapture er section 47, the property will be ed as not used in a trade or busi- of the taxpayer. However, for pur- s of applying the recapture rules of ion 47 pursuant to the preceding ence, converting the use of the erty from use in a trade or business se in the production of income will reated as a conversion to personal

) *Basis; application with section* 5. The basis of property with re- t to which there is recapture under graph (e)(1) of this section shall be eased immediately before the event lting in such recaptured by the unt recaptured. If section 1245(a) ies to a disposition of property, is no recapture under paragraph 1) of this section.

) *Examples.* Paragraphs (e)(1) ugh (3) of this section are trated by the following examples:

mple (1). A, an individual who is a calen- ear taxpayer, purchases and places in service nuary 1, 1983, section 179 property, which o 3-year recovery property under section costing $10,000. A elects to expense $5,000 cost (see section 179(b)(1)) and makes no on under section 168(b)(3). On January 1, A converts the property from use in A's ss to use for the production of income, and s the property in the latter capacity for the year. A elects to itemize deductions for Since the property was not predominantly n a trade or business of A in 1984, which he first taxable year following the taxable he property was placed in service. A must ure any benefit derived from expensing the ty under section 179. Had A not elected to expense the $5,000 in 1983, A would have been entitled to deduct, under section 168(a) and (b), 25 percent of the $5,000 in 1983, and 38 percent of the $5,000 in 1984. Therefore, A must include in ordinary income for the 1984 taxable year, the excess of $5,000 (the section 179 expense amount) over $3,150 (63 percent of $5,000), or $1,850. For purposes of computing the deduction under section 168 in 1985, the unadjusted basis of the property would be increased by $5,000.

Example (2). Assume the facts are the same as in example (1), except that during 1984 A uses the property 40 percent for trade or business purposes and 60 percent for personal use. Had A not elected to expense the $5,000 in 1983, A would have been entitled to deduct, under section 168(a), 25 percent of the $5,000 in 1983 and 15.2 percent (40 percent of 38 percent) of the $5,000 in 1984. See section 168(d)(1) and the regulations thereunder. Therefore, A must include in ordinary income for the 1984 taxable year the excess of $5,000 over $2,010 (40.2 percent of $5,000), or $2,990. If A uses the property solely in A's trade or business during 1985, A may deduct 37 percent of $5,000 in 1985 under section 168(a).

(f) *Basis*—(1) *In general.* A taxpayer who elects to expense under section 179 must reduce the unadjusted basis of the section 179 property by the amount of the section 179 expense deduction. See section 168(d)(1) and the regulations thereunder.

(2) *Special rules for partnerships and S corporations.* Generally, the basis of a partnership or S corporation's section 179 property must be reduced to reflect the amount of section 179 expense elected by the partnership or S corporation. However, since a partner or shareholder that is a trust or estate may not deduct its allocable share of the section 179 expense elected by the partnership or S corporation, a partnership or S corporation's basis in section 179 property shall not be reduced to reflect any portion of the section 179 expense that is allocable to the trust or estate.

(g) *Disallowance of the section 38 credit.* If a taxpayer elects to expense under section 179, no section 38 credit is allowable for the portion of the cost expensed. In addition, no section 38 credit shall be allowed under section 48(d) to a lessee of property for the portion of the cost of the property that the lessor expensed under section 179.

(h) *Partnerships and S corporations.* In the case of property purchased and placed in service by a partnership or S corporation, the determination of whether the property is section 179 property is to be made at the partnership or S corporation level, and the election to expense the cost of section 179 property is made by the partnership or S corporation. See sections 703(b), 1363(c), 6221, 6231(a)(3), 6241, and 6245. This paragraph (h) is illustrated by the following example:

Example. A is an individual taxpayer who owns certian residential property as an investment. A, and others, form ABC partnership whose function is to rent and manage such property. A and ABC partnership file their income tax returns on a calendar year basis. In 1984, ABC partnership purchases and places in service section 179 property. Assuming ABC partnership satisfies the section 179 election requirements and chooses to make an election for the property purchased, A will be entitled, subject to the limitation contained in section 179(b), to deduct A's share of the expense allocated to A by the partnership. Although such property was only for the production of income with respect to A, the property was being used in ABC's trade or business. Therefore, since the determination of whether property is section 179 property is made at the partnership level, the property was properly expensed.

(i) *Leasing of section 179 property*—(1) *In general.* A lessor of section 179 property who is treated as the owner of the property for Federal tax purposes will be entitled to the section 179 expense deduction if the requirements of section 179 and the regulations thereunder are met. These requirements will not be met if the lessor merely holds the property for the production of income. For certain leases entered into prior to January 1, 1984, the safe harbor provisions of section 168(f) (8) apply in determining whether an agreement is treated as a lease for Federal tax purposes.

(2) *Noncorporate lessor.* In determining the class of taxpayers (other than an estate or trust) for which section 179 is applicable, section 179(d)(5) provides that if a taxpayer is a noncorporate lessor (as described in section 46(e)(3)), the taxpayer shall not be entitled to claim a section 179 expense for property purchased by the taxpayer unless a credit under section 38 is allowable to the taxpayer for such property (determined without regard to section 179). Thus, for example, if a taxpayer, a noncorporate lessor, purchases section 179 property and leases it and the taxpayer would be entitled to a section 38 credit for the property, by having satisfied all the requirements of subparagraph (A) or (B) of section 46(e)(3) and the regulations thereunder, the taxpayer is not precluded by section 179(d)(5) from electing to claim a sec-

tion 179 expense for such property.

(j) *Cross references.* See section 453(i) and the regulations thereunder with respect to installment sales of section 179 property. See section 263(a)(1)(H) and the regulations thereunder with respect to capitalizing section 179 property. See section 1033(g)(3) and the regulations thereunder relating to condemnation of outdoor advertising displays. See section 1245(a) and the regulations thereunder with respect to recapture rules for section 179 property.

§1.179-2 Dollar Limitation.

(a) *Maximum amount subject to election.* Section 179(b) limits the aggregate cost of section 179 property that a taxpayer may elect to expense under section 179 for any one taxable year. For a taxable year beginning in 1982, 1983, 1984, 1985, 1986, or 1987, the dollar limitation on the amount that can be expensed is $5,000; for a taxable year beginning in 1988 or 1989, $7,500; and for a taxable year beginning after 1989, $10,000. The dollar limitation of section 179(b) applies to each taxpayer and not to each trade or business in which the taxpayer has an interest. However, for property placed in service after June 18, 1984, in taxable years ending after such date, see sections 280F(a) and (d)(1) relating to the coordination of section 179 with the limitation on the amount of investment tax credit and depreciation for luxury automobiles. See paragraphs (b) through (f) of this section for special rules on applying the dollar limitation of section 179(b) with respect to controlled groups of corporations, partnerships, S corporations, and married individuals.

(b) *Component members of a controlled group*—(1) *In general.* Component members of a controlled group (as defined in paragraph (g) of §1.179-3) on a December 31 shall be treated as one taxpayer in applying the dollar limitation of section 179(b) and paragraph (a) of this section. The expense deduction under section 179 may be taken by any one such member or allocated (for the taxable year of each such member which includes such December 31) among the several members in any manner, pursuant to an allocation by the common parent corporation if a consolidated return is filed for all component members of the group, or in accordance with an agreement entered into by the members of the group if separate returns are filed. If a consolidated return is filed by some component members of the group and separate returns are filed by other component members, then the common parent of the group filing the consolidated return shall enter into an agreement with those members who do not join in filing the consolidated return allocating the amount between the group filing the consolidated return and the other component members of the controlled group who do not join in filing the consolidated return. The amount of the expense allocated to any component member, however, shall not exceed the cost of the section 179 property actually purchased by the member and placed in service by the member in the taxable year. If component members have different taxable years, the term "taxable year" in section 179(b)(1) shall mean the taxable year of the member whose taxable year begins on the earliest date.

(2) *Statement to be filed.* If a consolidated return is filed, the common parent corporation shall file a separate statement attached to the income tax return in which an election is made to claim an expense deduction under section 179. See §1.179-4. If separate returns are filed by some or all component members of the group, each component member not included in a consolidated return to which is allocated any part of the deduction under section 179 shall file a separate statement attached to the income tax return in which an election is made to claim an expense deduction. Such statement shall include the name, address, employer identification number, and the taxable year of each component member of the controlled group, a copy of the allocation agreement signed by persons duly authorized to act on behalf of the component members, and a description of the manner in which the deduction under section 179 has been divided among them.

(3) *Revocation.* If a consolidated return is filed for all component members of the group, an allocation among such members of the expense deduction under section 179 shall not be revoked after the due date of the return (including extensions of time) of the common parent corporation for the taxable year for which an election to take an expense deduction is made. If some or all of the component members of the controlled group file separate returns for taxable years including a particular December 31 for which an election to take the expense deduction is made, the allocation as to all members of the group shall not be revoked after the due date of the return (including extensions of time) of the component member of the controlled group whose taxable year which includes such December 31 ends on the latest date.

(c) *Partnerships*—(1) *In general.* The dollar limitation of section 179(b) and paragraph (a) of this section applies to the partnership as well as to each partner. Thus, neither a partnership nor a partner may deduct as a section 179 expense more than the amount provided for in section 179(b) and paragraph (a) of this section in any taxable year. In the case of a partner who is a member of two or more partnerships that elect section 179, the partner's aggregate share of the partnership section 179 expense may not exceed the dollar limitation of section 179(b). In the case of a member of a parternship that elects under section 179 who also has separately acquired section 179 property, the aggregate amount of the member's partnership and non-partnership section 179 expense may not exceed the dollar limitation of section 179(b).

(2) *Partner's share of section 179 expense.* Section 704 and the regulations thereunder shall govern the determination of a partner's share of a partnership's section 179 expense for any taxable year. However, no allocation among partners of the section 179 expense shall be modified after the due date of the partnership return (without regard to extensions of time) for the year for which the election under section 179 is made.

(3) *Taxable year.* If the taxable years of a partner and the partnership do not coincide, then for purposes of section 179, the amount of a partnership's section 179 expense attributable to a partner is determined in accordance with the provisions of section 706 and the regulations thereunder. For example, partnership AB has a taxable year ending Janaury 31. Taxpayer A, a

member of the AB partnership, has a taxable year ending November 30. On March 10, 1984, the AB partnership purchases and places in service section 179 property. Under the provisions of section 706(a) and §1.706-1(a)(1), taxpayer A will be unable to claim any section 179 expense until A's taxable year ending November 30, 1985.

(d) *S Corporations.* For taxable years beginning after December 31, 1982, rules similar to those contained in paragraphs (c)(1) through (3) of this section shall apply in the case of S corporations (as defined in section 13619a)) and their shareholders. Each shareholder's share of the section 179 expense of an S corporation shall be determined under section 1366.

(e) *Joint returns*—(1) *In general.* A husband and wife who file a joint income tax return under section 6013(a) shall be treated as one taxpayer in applying the dollar limitation of section 179(b)(1) and paragraph (a) of this section, regardless of which spouse purchased the property.

(2) *Joint returns filed after separate returns.* In the case of a husband and wife who elect under section 6013(b) to file a joint income tax return for a taxable year after the time prescribed by law for filing the return for such taxable year has expired; the dollar limitation under section 179 shall be the full dollar amount permitted by section 179(b)(1) provided the amount of one or both of the spouses' section 179 expense elections on their separate returns was limited as a result of the dollar limitation of section 179(b)(2) and paragraph (f) of this section. However, where neither of the spouses' section 179 expense elections on their separate returns was limited by the section 179(b)(2) dollar limitation, then the maximum dollar amount permitted on the joint return is the aggregate dollar amount the spouses elected on their separate returns. For example, H and W, who are calendar year taxpayers, purchase and place in service in 1983 section 179 property costing $10,000. H and W file separate income tax returns for the 1983 taxable year. H elects to claim $2,000 as an expense and W elects to expense $2,000. After the due date of the return H and W elect under section 6013(b) to file a joint income tax 1983. H and W may only elect to expense $4,000 on their joint income tax return.

(f) *Married individuals filing separately.* In the case of an individual who is married but files a separate tax return, the maximum amount of section 179 property which the taxpayer may elect to expense is 50 percent of the amount otherwise determined under section 179(b)(1) and paragraph (a) of this section. For this purpose, marital status shall be determined under section 143 and the regulations thereunder. For example, H and W are calendar year taxpayers. In 1983, H and W purchased and placed in service section 179 property costing $10,000. For the 1983 taxable year, H and W are living apart within the meaning of section 143 (b) and therefore are not considered married. H and W are each entitled to claim a section 179 expense of up to $5,000.

§1.179-3 Definitions.

The following definitions apply for purposes of section 179 and §§1.179-1 through 1.179-5:

(a) *Section 179 property.* The term "section 179 property" means any recovery property which is section 38 property and which is acquired by purchase for use in the taxpayer's trade or business. For this purpose, the term "trade or business" has the same meaning as in section 162 and the regulations thereunder. For definitions of the terms "recovery property," "section 38 property," and "purchase," see paragraphs (b), (c), and (d) of this section.

(b) *Recovery property.* The term "recovery property" shall have the same meaning assigned to it in section 168 (c)(1)(A) and the regulations thereunder.

(c) *Section 38 property.* The term "section 38 property" shall have the same meaning assigned to it in section 48(a) and the regulations thereunder.

(d) *Purchase.* (1)(i) Except as otherwise provided in paragraph (d)(2) of this section, the term "purchase" means any acquisition of the property, but only if all the requirements of paragraphs (d)(1)(ii), (iii), and (iv) of this section are satisfied.

(ii) Property is not acquired by purchase if it is acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under section 267 or 707(b). The property is considered not acquired by purchase only to the extent that losses would be disallowed under section 267 or 707(b). Thus, for example, if property is purchased by a husband and wife jointly from the husband's father, the property will be treated as not acquired by purchase only to the extent of the husband's interest in the property. However, in applying the rules of section 267(b) and (c) for this purpose, section 267(c)(4) shall be treated as providing that the family of an individual will include only his spouse, ancestors, and lineal descendants. For example, a purchase of property from a corporation by a taxpayer who owns, directly or indirectly, more than 50 percent in value of the outstanding stock of such corporation does not qualify as a purchase under section 179(d)(2); nor does the purchase of property by a husband from his wife. However, the purchase of section 179 property by a taxpayer from his brother or sister does qualify as a purchase for purposes of section 179(d)(2).

(iii) The property is not acquired by purchase if acquired from a component member of a controlled group of corporations (as defined in paragraph (g) of this section) by another component member of the same group.

(iv) The property is not acquired by purchase if the basis of the property in the hands of the person acquiring it is determined in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or is determined under section 1014(a), relating to property acquired from a decedent. For example, property acquired by gift of bequest does not quality as property acquired by purchase for purposes of section 179(d)(2); nor does property received in a corporate distribution the basis of which is determined under section 301(d)(2)(B), property acquired by a corporation in a transaction to which section 351 applies, property acquired by a partnership through contribution (section 723), or property received in a partnership distribution which has a carryover basis under section 732(a)(1).

(2) Property deemed to have been acquired by a new target corporation as a result of a section 338 election (relating to certain stock purchases treated as as-

set acquisitions) will be considered acquired by purchase.

(e) *Cost.* The cost of section 179 property does not include so much of the basis of such property as is determined by reference to the basis of other property held at any time by the taxpayer. For example, X Corporation purchases a new drill press costing $10,000 in November 1984 which qualifies as section 179 property, and is granted a trade-in allowance of $2,000 on its old drill press. The old drill press had a basis of $1,200. Under the provisions of sections 1012 and 1031(d), the basis of the new drill press is $9,200 ($1,200 basis of old drill press plus cash expended of $8,000). However, only $8,000 of the basis of the new drill press qualifies as cost for purposes of the section 179 expense deduction; the remaining $1,200 is not part of the cost because it is determined by reference to the basis of the old drill press.

(f) *Placed in service.* The term "placed in service" means the time that property is first placed by the taxpayer in a condition or state of readiness and availability for a specifically assigned function, whether for use in a trade or business, for the production of income, in a tax-exempt activity, or in a personal activity. See §1.46-3(d)(2) for examples regarding when property shall be considered in a condition or state of readiness and availability for a specifically assigned founction.

(g) *Controlled group of corporations and component member of controlled group.* The terms "controlled group of corporations" and "component member" of a controlled group of corporations shall have the same meaning assigned to those terms in sections 1563(a) and (b), except that the phrase ""more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in section 1563(a)(1).

§1.179-4 Time and manner of making election.

(a) *Election.* A separate election must be made for each taxable year in which a section 179 expense deduction is claimed with respect to section 179 and §1.179-1 to claim a section 179 expense deduction for section 179 property shall be made on the taxpayer's income tax return for the taxable year to which the election applies. If the taxpayer does not file a timely return (taking into account extensions of time for filing) for such taxable year, the election shall be made at the time the taxpayer files the first return for such year. The election may be made on a return, as amended, filed within the time prescribed by law (including extensions) for filing the return for such taxable year. The election shall be made by showing as a separate item on the taxpayer's income tax return the following items:

(1) The total section 179 expense deduction claimed with respect to all section 179 property selected; and

(2) The portion of that deduction allocable to each specific item.

The person shall maintain records which permit specific identification of each piece of section 179 property and reflect how and from whom such property was acquired and when such property was placed in service. The election to claim a section 179 expense deduction under this section, with respect to any property, is irrevocable and will be binding on the taxpayer with respect to such property for the taxable year for which the election is made and for all subsequent taxable years, unless the Commissioner consents to the revocation of the election. Similarly, the selection of section 179 property by the taxpayer to be subject to the expense deduction and apportionment scheme must be adhered to in computing the taxpayer's taxable income for the taxable year for which the election is made and for all subsequent taxable years, unless consent to change is given by the Commissioner.

(b) *Revocation.* Any election made under section 179, and any specification contained in such election, may not be revoked except with the consent of the Commissioner. Such consent will be granted only in extraordinary circumstances. Requests for consent must be filed with the Commissioner of Internal Revenue, Washington D.C., 20224. The request must include the name, address, and taxpayer identification number of the taxpayer and must be signed by the taxpayer or his duly authorized representative. It must be accompanied by a statement showing the year and property involved, and must set forth in detail the reasons for the request.

Par. 3. A new §1.179-5 is added immediately following §1.179-4 to read as set forth below.

§1.179-5 Effective date.

In general, the provisions of §§1.179-1 through 1.179-4 apply to property placed in service after December 31, 1980, in taxable years ending after such date. However, §1.179-2(d), relating to the application of the dollar limitation rules with respect to S corporations, shall be effective for taxable years beginning after December 31, 1982.

Par. 4. Section 1.263(a)-1 is amended by redesignating paragraphs (c)(4) and (5) as (c)(5) and (6) respectively, and adding a new paragraph (c)(4) before designated paragraph (c)(5) to read as set forth below.

§1.263(a)-1 Capital expenditures; in general.

* * * * *

(c) * * *

(4) Section 179 and §§1.179-1 through 1.179-5, rrelating to election to expense certain depreciable business assets,

* * * * *

Par. 5. Section 1.263(a)-3 is amended by redesignating paragraphs (b)(5), (6), (7), (8), (9), and (10) as (b)(6), (7), (8), (9), (10) and (11) respectively, and adding a new paragraph (b)(5) before redesignated paragraph (b)(6) to read as set forth below.

§1.263(a)-3 Election to deduct or capitalize certain expenditures.

(b) * * *

(5) Section 179 (election to expense certain depreciable business assets).

* * * * *

Par. 6. Section 1.1033(g)-1 is amended by revising the fourth sentence of paragraph (b)(1) to read as set forth below.

§1.1033(g)-1 Condemnation of real property held for productive use in trade or business or for investment.

* * * * *

(b) *Election to treat outdoor advertising displays as real property*—(1) * * * No election may be made with respect to any property for which (i) the investment credit under section 38

has been claimed, or (ii) an election to expense certain depreciable business assets under section 179(a) is in effect.
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Par. 7. The second sentence of paragraph (a)(3) of §1.1245-2 is revised by removing "additional first-year depreciation allowance for small business" and adding in its place "expense allowance (additional first-year depreciation allowance for property placed in service before January 1, 1981)".

These regulations are proposed to be issued under the authority contained in sections 179(c), 179(d)(10), and 7805 of the Internal Revenue Code of 1954 (95 Stat. 219, 96 Stat. 2369, 68A Stat. 917; 26 U.S.C. 179(c), 179(d)(10), 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on September 25, 1985, 8:45 a.m., and published in the issue of the Federal Register for September 26, 1985, 50 F.R. 39018)

Notice of Proposed Rulemaking

Investment Tax Credit for Certain Rehabilitation Expenditures

LR-238-81

SUMMARY: This document contains proposed regulations under sections 46 and 48 of the Internal Revenue Code of 1954 relating to an investment tax credit for rehabilitation expenditures incurred in connection with the rehabilitation of a qualified rehabilitated buidling. Also, changes are made to the regulations under section 191 to reflect the repeal of that section. Changes to the applicable law were made by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256], the Technical Corrections Act of 1982 [Pub. L. 97-448, 1983-1 C.B. 451], and the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. The regulations would provide the public with the guidance needed to comply with the law as amended by the Act.

DATES: Written comments and requests for a public hearing must be delivered or mailed by August 27, 1985. The amendments would be effective generally for rehabilitation expenditures incurred after December 31, 1981.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-238-81), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: John G. Schmalz of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224 (Attention:CC:LR:T) (202-566-3516).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 46, 48, and 191 of the Internal Revenue Code of 1954. Generally, these amendments are proposed to conform the Income Tax Regulations to section 212 of the Economic Recovery Tax Act of 1981 (95 Stat. 235) [Pub. L. 97-34, 1981-2 C.B. 256, 291], section 102(f) of the Technical Corrections Act of 1982 (96 Stat. 2371) [Pub. L. 97-448, 1983-1 C.B. 451, 454], and sections 31(c), 111(e)(8), and 1043(a) of the Tax Reform Act of 1984 (98 Stat. 518, 631, and 1044) [1984-3 C.B. (Vol. 1) 1, 26, 141, 552].

Section 38 of the Internal Revenue Code provides for a credit against tax in the case of investment in certain depreciable property (*i.e.*, section 38 property). Section 48(a)(1)(E) of the Code defines section 38 property so as to include the portion of the basis of a qualified rehabilitated building that is attributable to qualified rehabilitation expenditures. Section 48(g) and §1.48-12 define the terms "qualified rehabilitated building" and "qualified rehabilitation expenditure". Section 46(b)(4)(A) provides rules for determining the rehabilitation percentage that is to be applied to qualified rehabilitation expenditures in order to determine the amount of the investment tax credit that is allowable under section 38 to a taxpayer.

REHABILITATION PERCENTAGE

The Economic Recovery Tax Act of 1981 provided for a three-tier rehabilitation percentage in the case of qualified rehabilitation expenditures. In general, section 46(b)(4)(A) provides that the rehabilitation percentage is 15 percent in the case of a 40-year building, and 25 percent in the case of a certified historic structure. Section 46(b)(4)(B) provides that the regular percentages and the energy percentages do not apply to that portion of the basis of any property which is attributable to qualified rehabilitation expenditures. Section 46(b)(4)(C) provides definitions relating to the three types of buildings. In general, a 30-year building is a building where 30 years have lapsed between the date the building was first placed in service and the date physical work on the rehabilitation work on the rehabilitation began. A 40-year building is a building where 40 years have elapsed between these dates. The proposed regulations provide for an allocation rule in certain cases where additions have been made to a building.

PROPERTY USED FOR LODGING

In general, section 48(a)(3) provides that section 38 property does not include property which is used predominantly to furnish lodging. The Economic Recovery Tax Act amended section 48(a)(3) to provide an exception to this exclusion in the case of certified historic structures.

QUALIFIED REHABILITATED BUILDINGS

The term "qualified rehabilitated building" is defined in section 48(g)(1) and §1.48-12(b). In order to qualify as a qualified rehabilitated building, four requirements must be met. First, the building must have been placed in service before the beginning of the rehabilitation. Second, at least 75 percent of the existing external walls of the building generally must be retained as external walls. Third, thirty years must have elapsed between the date the building was first placed in service and the date the physical work on the rehabilitation began. Fourth, the building must have been substantially rehabilitated.

The Tax Reform Act of 1984 added section 48(g)(1)(E) which provides for an alternative "external wall" test. Although the portion of these proposed regulations dealing with the new test is reserved, the Treasury Department invites public comment on this topic. Specifically, the Treasury Department invites public comment on the interpre-

tation of the term "internal structural framework" in section 48(g)(1)(E).

The proposed regulations contain additional restrictions applying in the cases of buildings that have been moved. Rehabilitation is distinguished from new construction in these proposed regulations. A quantitative test for substantial rehabilitation is provided in section 48(g)(1)(C) and §1.48-12(b)(2). In general, the qualified rehabilitation expenditures during the appropriate measuring period must exceed the greater of $5,000 or the adjusted basis of the property. The proposed regulations provide rules for applying the test in various contexts.

QUALIFIED REHABILITATION EXPENDITURE

The term "qualified rehabilitation expenditure" is defined in section 48(g)(2) and §1.48-12(c). In general, the expenditures must be for property chargeable to capital account and must be incurred after December 31, 1981, for real property with a recovery period of 18 years in connection with the rehabilitation of qualified rehabilitated building. Section 48(g)(2)(B) and §1.48-12(c) exclude certain expenditures from the definition of qualified rehabilitation expenditures. The proposed regulations clarify that the term "qualified rehabilitation expenditures" is not limited to those expenditures incurred during the relevant measuring period used for purposes of the substantial rehabilitation test. In the case of rehabilitated property placed in service in a taxable year, if the building qualifies as a qualified rehabilitated building for that year, the taxpayer can claim as qualified rehabilitation expenditures the expenditures incurred before the beginning of the measuring period, during the measuring period, and after the measuring period but before the end of the taxable year.

CERTIFIED HISTORIC STRUCTURE

The term "certified historic structure" is defined in section 48(g)(3) and §1.48-12(d). In general, a certified historic structure is a building (and its structural components) which is listed in the National Register, or which is located in a registered historic district and is certified by the Secretary of the Interior as being of historic significance to the district. Although procedures for obtaining a National Register listing or a certification of significance are generally within the authority of the Department of Interior, (and therefore outside the scope of the Internal Revenue Code), these proposed regulations do address the issue of when a 25 percent investment tax credit can be claimed in the case of a pending application for certification by the Department of Interior.

ADJUSTMENTS TO BASIS

Section 48(8) and §1.48-12(e) provide rules concerning an adjustment to the basis of the qualified rehabilitated buildings. In general, the increase in the basis of the building that would result from the qualified rehabilitation expenditures must be reduced by the amount of the credit allowed under section 38 (50 percent of the credit in the case of a certified historic structure).

COORDINATION WITH OTHER PROVISIONS

Section 1.48-12(f) provides rules relating to the coordination between section 48(g) and various other provisions of the Internal Revenue Code of 1954. Rules and cross-references to other provisions of the Code are provided.

SECTION 191

Section 191, relating to amortization of rehabilitation expenditures for certified historic structures, was repealed by the Economic Recovery Tax Act of 1981 for expenditures incurred after December 31, 1981. These proposed regulations reflect the repeal.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request of any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer of Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that the proposed rule is not a major rule as defined in Executive Order 12291 or the Treasury-Office of Management and Budget implementation of that order, dated April 29, 1983. Accordingly, a Regulatory Impact Analysis is not required. Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of these proposed regulations is John G. Schmalz of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations both on matters of substance and style.

* * * * *

Proposed amendments to the regulations

The proposed amendments to 26 CFR Part 1 are as follows:

Paragraph 1. These regulations are issued under the authority of 26 U.S.C. 7805 and 26 U.S.C. 48(g)(1)(C)(i) and (iii). The authority citation for Part 1 is amended by inserting in the appropriate place "§1.48-12 also issued under 26

U.S.C. 48(g)(1)(C)(i) and (iii);".

Par. 2. Section 1.46-1 is amended by revising paragraphs (a)(2) and (d), by adding a new subparagraph (5) to paragraph (e), and by adding a new paragraph (q) at the end thereof, to read as follows:

§1.46-1 Determination of amount.

(a) *Effective dates.* * * *

(2) *Acts covered.* This section reflects changes made by the following Acts of Congress:

Act and Section

Tax Reduction Act of 1975, section 301 [Pub. L. 94-12, 1975-1 C.B. 545, 551].

Tax Reform Act of 1976, section 802, 1701, 1703 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 56, 235, 237].

Revenue Act of 1978, section 311, 312, 315 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 58, 52].

Energy Tax Act of 1978, section 301 [Pub. L. 95-618, 1978-3 C.B. (Vol. 2), 1, 20].

Economic Recovery Tax Act of 1981, section 212 [Pub. L. 97-34, 1981-2 C.B. 256, 291].

Technical Corrections Act of 1982, section 102(f) [Pub. L. 97-448, 1983-1 C.B. 451, 454].

* * * * *

(d) *Credit earned.* The credit earned for the taxable year is the sum of the following percentages of qualified investment (as determined under section 46(c) and (d))—

(1) The regular percentage (as determined under section 46(a)(2)(B)),

(2) For energy property, the energy percentage (as determined under section 46(a)(2)(C)),

(3) The ESOP percentage (as determined under section 46(a)(2)(E)), and

(4) For the portion of the basis of a qualified rehabilitated building (as defined in §1.48-12(b)) that is attributable to qualified rehabilitation expenditures (as defined in §1.48-12(c)), the rehablitation percentage (as determined under section 46(b)(4)).

(e) *Designation of credits.* The credit available for the taxable year is designated as follows:

* * * * *

(5) The credit attributable to the rehabilitation percentage for qualified rehabilitation expenditures in the rehabilitation investment credit.

* * * * *

(g) *Rehabilitation percentage*—(1) *In general.* For qualified rehabilitation expenditures (as defined in §1.48-12(c)), section 46(b)(4)(A) provides for a three-tier rehabilitation percentage. The applicable rehabilitation percentage depends on whether the qualified rehabilitation building is a "30-year building," a "40-year building," or a certified historic structure (as defined in section 48(g)(3) and 1.48-12(d)). The rehabilitation percentage for qualified rehabilitation expenditures incurred with respect to a qualified rehabilitated building is 15 percent to the extent that the building is a 30-year building (*i.e.*, at least 30 years, but less than 40 years, has elapsed between the date the physical work on the rehabilitation began and the date the building was first placed in service), 20 percent to the extent that the building is a 40-year building (*i.e.*, at least 40 years has so elapsed), and 25 percent for certified historic structures, regardless of age. For purposes of this paragraph (q), a building is not a "30-year building" unless it has been at the location where it is being rehabilitated for the thirty-year period immediately preceding the beginning of the rehabilitation process, and is not a "40-year building" unless it has been at the location where it is being rehabilitated for the forty-year period immediately preceding the beginning of the rehabilitation process. See §1.48-12(b)(5). Also, for purposes of this paragraph (q), a building (other than a certified historic structure) is not a qualified rehabilitated building to the extent of that portion of the building that is less than 30 years old. If rehabilitation expenditures are incurred with respect to an addition to a qualified rehabilitated building, but the addition is not considered to be part of the qualified rehabilitated building because the addition does not meet the thirty-year requirement in section 48(g)(1)(B) and §1.48-12(b)(4), then no rehabilitation percentage will be applied to the expenditures attributable to the rehabilitation of the addition. Thus, for purposes of this paragraph (q)(1), it may be necessary to allocate rehabilitation expenditures incurred with respect to a building between the original portion of the building and the addition. Furthermore, if qualified rehabilitation expenditures are incurred for property that is excluded from section 38 property described in section 48(a)(1)(E) (because, for example, they are made with respect to a portion of the building used for lodging within the meaning of section 48(a)(3) and §1.48-1(h)), a similar allocation of the expenditures must be made between the expenditures that result in basis that is section 38 property and the expenditures that do not result in basis that in section 38 property since the rehabilitation percentage is applicable only to section 38 property. These allocations should be made using the principles contained in §1.48-12(c)(9)(ii).

(2) *Regular and energy percentages not to apply.* The regular percentage and the energy percentage shall not apply to that portion of the basis of any building that is attributable to qualified rehabilitation expenditures (as defined in §1.48-12(c)).

(3) *Effective date.* The rehabilitation percentage is applicable only to qualified rehabilitation expenditures (as defined in §1.48-12(c)). For rules relating to applicability of the regular percentage to qualified rehabilitation expenditures (as defined in §1.48-11(c)), see §1.48-11.

Par. 3. Section 1.48-1 is amended by adding a new subdivision (iii) to paragraph (h)(1) and a new subdivision (iv) to paragraph (h)(2) to read as follows:

§1.48-1 Definition of Section 38 property.

* * * * *

(h) *Property used for lodging*—(1) *In general.* * * *

(iii) Notwithstanding any other provision of this paragraph (h), in the case of a qualified rehabilitated building (within the meaning of section 48(g)(1) and §1.48-12(b)), expenditures for property resulting in basis described in section 48(a)(1)(E) shall not be treated as section 38 property to the extent that such property is attributable to a portion of the building that is used for lodging or in connection with lodging. For example, if expenditures are incurred to rehabilitate a five story qualified rehabilitated building, three floors of which are used for apartments and two floors of which are used as commercial office space, the expenditures attributable to the commercial part

of the building are not expenditures for property, or in connection with property, used predominantly for lodging. Allocation of expenditures between the two portions of the building are to be made using the principles contained in §1.48-12(c)(9)(ii).

(2) *Exceptions.* * * *

(iv) *Certified historic structures.* For purposes of this paragraph (h), regardless of the actual use of a certified historic structure, that portion of the basis of such certified historic structure which is attributable to qualified rehabilitation expenditures (as defined in §1.48-12(c)) shall not be considered as property which is either used predominantly to furnish lodging or predominantly in connection with the furnishing of lodging. Accordingly, such portion of the basis may qualify as section 38 property. (For a definition of "certified historic structure," see section 48(g)(3) and §1.48-12(d).)

Par. 4. There is inserted immediately after §1.48-11 a new §1.48-12 to read as follows:

§1.48-12 Qualified rehabilitated building; expenditures incurred after December 31, 1981.

(a) *General rule*—(1) *In general.* Under section 48(a)(1)(E), the portion of the basis of a qualified rehabilitated building that is attributable to qualified rehabilitation expenditures (within the meaning of section 48(g) and this section) is section 38 property. Property that is section 38 property by reason of section 48(a)(1)(E) is treated as new section 38 property and, therefore, is not subject to the used property limitation in section 48(c). Section 48(g)(1) and paragraph (b) of this section define the term "qualified rehabilitated building." Section 48(g)(2) and paragraph (c) of this section define the term "qualified rehabilitation expenditure." Section 48(g)(2)(B)(iv) and (3) and paragraph (d) of this section describe the rules applicable to "certified historic structures." Section 48(q) and paragraph (e) of this section provide rules concerning an adjustment to the basis of the rehabilitated building. Paragraph (f) of this section provides guidance for coordination of these provisions with other sections of the Code.

(2) *Effective date*—(i) *In general.* Except as otherwise provided in this paragraph, this section applies to expenditures incurred after December 31, 1981, in connection with the rehabilitation of a qualified rehabilitated building. (See paragraph (c)(3)(i) of this section for rules concerning the determination of when an expenditure is incurred.) If, however, physical work on the rehabilitation began before January 1, 1982, and the building does not meet the requirements of paragraph (b) of this section, the rules in §1.48-11 shall apply to the expenditures incurred after December 31, 1981, in connection with such rehabilitation. (See paragraph (b)(6)(i) of this section for rules determining when physical work on a rehabilitation begins.) For property placed in service before March 16, 1984, and any property subject to the exception set forth in section 111(g)(2) of Public Law 98-369 (Deficit Reduction Act of 1984) [1984-3 C.B. (Vol. 1) 1, 29], the references to "18 years" in paragraphs (c)(1)(iii), (c)(2), (c)(4), and (c)(7)(v) shall be replaced with "15 years" and the reference to "18-year real property" in paragraph (c)(4) shall be replaced with "15-year real property."

(ii) *Transition rule concerning external wall definition.* Notwithstanding the definition of external wall contained in paragraph (b)(3)(iii) of this section, in any case in which the written plans and specifications for a rehabilitation were substantially completed on or before June 28, 1985, and the building being rehabilitated would fail to meet the requirement of paragraph (b)(1)(iii) of this section if the definition of external wall in paragraph (b)(3)(iii) of this section were used, then the term "external wall" shall be defined as a wall, including its supporting elements, with one face exposed to the weather or earth, and a common wall shall not be treated as an external wall. See paragraph (b)(2)(v) of this section for the definition of written plans and specifications.

(b) *Definition of qualified rehabilitated building*— (1) *In general.* The term "qualified rehabilitated building" means any building and its structural components—

(i) That has been substantially rehabilitated (within the meaning of paragraph (b)(2) of this section),

(ii) That was placed in service (within the meaning of §1.46-3(d)) as a building by any person before the beginning of the rehabilitation, and

(iii) 75 percent or more of the existing external walls of which are retained in place as external walls in the rehabilitation process (within the meaning of paragraph (b)(3) of this section).

See paragraph (b)(4) and (5) of this section for additional requirements related to the definition of a qualified rehabilitated building.

(2) *Substantially rehabilitated building*—(i) *Substantial rehabilitation test.* A building shall be treated as having been substantially rehabilitated for a taxable year only if the qualified rehabilitation expenditures (as defined in paragraph (c) of this section) incurred during any 24-month period selected by the taxpayer ending with or within the taxable year exceed the greater of

(A) the adjusted basis of the building (and its structural components), or

(B) $5,000.

(ii) *Date to determine adjusted basis of the building*—(A) *In general.* The adjusted basis of the building (and its structural components) shall be determined as of the beginning of the first day of the 24-month period selected by the taxpayer or the first day of the taxpayer's holding period of the building (within the meaning of section 1250(e)), whichever is later. For purposes of determining the holding period under section 1250(e), any reconstruction that is part of the rehabilitation shall be disregarded.

(B) *Special rules.* In the event a building is not owned by the taxpayer, the adjusted basis of the building shall be determined as of the date that would have been used if the owner had been the taxpayer. The adjusted basis of a building that is being rehabilitated by a taxpayer other than the owner shall thus be determined as of the beginning of the first day of the 24-month period selected by the taxpayer or the first day of the owner's holding period, whichever is later. Therefore, if a building that is being rehabilitated by a lessee is sold subject to the lease prior to the date that the lessee has substantially rehabilitated the building, the lessee's adjusted basis is determined as of the beginning of the first day of the new lessor's holding period or the beginning of the first day of the 24-month period selected by the lessee (the taxpayer), whichever is later. If, therefore, the

irst day of the new lessor's holding pe-iod were later than the first day of the 4-month period selected by the lessee the taxpayer), the lessee's adjusted ba-is for purposes of the substantial reha-ilitation test would be the same as the djusted basis of the new lessor as de-ermined under paragraph (b)(2)(vii) of his section. If a building is sold after ne date that a lessee has substantially ehabilitated the building with respect o the original lessor's adjusted basis, owever, the lessee's basis may be de-ermined as of the first day of the 4-month period selected by the lessee r the first day of the original lessor's olding period, whichever is later, and e transfer of the building will not af-ct the adjusted basis for purposes of e substantial rehabilitation test.

(iii) *Adjusted basis of the uilding*—(A) *In general.* The term djusted basis of the building" means e aggregate adjusted basis (within the eaning of section 1011(a)) in the uilding (and its structural components) all the parties who have an interest the building.

(B) *Special rules.* In the case of a uilding that is leased to a tenant, the djusted basis of the building is deter-ined by adding the adjusted basis of e owner (lessor) in the building to the djusted basis of the lessee (or lessees) the leasehold and any leasehold im-ovements that are structural compo-nts of the building. Similarly, in the se of a building that is divided into ndominium units, the adjusted basis the building means the aggregate ad-sted basis of all of the respective con-minium owners (including the basis any lessee in the leasehold and lease-old improvements) in the building nd its structural components). If the djusted basis of a building would be termined in whole or in part by refer-ce to the adjusted basis of a person persons other than the taxpayer .g., a rehabilitation by a lessee) and e taxpayer is unable to obtain the re-ired information from such other per-n or persons, the adjusted basis of e building will be deemed to be the ir market value of the building. If a uilding is owned by a partnership e., the building is partnership prop-ty), adjusted basis is determined by king into account any adjustments to e basis of the building made under section 743 and section 734. Any adjustments to the building's basis that are made under section 743 or section 734 after the beginning of the partnership's holding period, but before the end of the measuring period, shall be deemed for purposes of the substantial rehabilitation test to have been made on the first day of the partnership's holding period. For purposes of determining the adjusted basis of a building, the portion of the adjusted basis of a building that is allocable to an addition (within the meaning of paragraph (b)(4)(ii) of this section) to the building that is less than thirty years old (within the meaning of section 48(g)(1)(B) and paragraph (b)(4)(i) of this section) shall be disregarded. (See paragraph (b)(2)(vii) of this section for a special rule applicable to the determination of the adjusted basis of a building when qualified rehabilitation expenditures are treated as incurred by the taxpayer.)

(iv) *Rehabilitation.* Rehabilitation includes renovation, restoration, or reconstruction of a building, but does not include an enlargement (within the meaning of paragraph (c)(9) of this section) or new construction. The determination of whether expenditures are attributable to the rehabilitation of an existing building or to new construction shall be based upon all the facts and circumstances.

(v) *Special rule for phased rehabilitation.* In the case of any rehabilitation that may reasonably be expected to be completed in phases set forth in written architectural plans and specifications completed before the physical work on the rehabilitation begins, paragraphs (b)(2)(i), (ii), and (vii) of this section shall be applied by substituting "60-month period" for "24-month period." A rehabilitation may reasonably be expected to be completed in phases if it consists of two or more distinct stages of development. The determination of whether a rehabilitation consists of distinct stages and therefore may reasonably be expected to be completed in phases shall be made on the basis of all the relevant facts and circumstances in existence before physical work on the rehabilitation begins. For purposes of this paragraph and paragraph (a)(2)(ii) of this section, written plans that describe generally all phases of the rehabilitation process shall be treated as written architectural plans and specifications. Such written plans are not required to contain detailed working drawings or detailed specifications of the materials to be used. In addition, the taxpayer may include a description of work to be done by lessees in the written plans. For example, where the owner of a vacant four story building plans to rehabilitate two floors of the building and plans to require, as a condition of any lease, that tenants of the other two floors must rehabilitate those floors, the requirements of this paragraph (b)(2)(v) shall be met if the owner provides written plans for the rehabilitation work to be done by the owner and a description of the rehabilitation work that the tenants will be required to complete. The work required of the tenants may be described in the written plans in terms of minimum specifications (*e.g.*, as to lighting, wiring, materials, appearance) that must be met by such tenants. See paragraph (b)(6)(i) of this section for the definition of physical work on a rehabilitation.

(vi) *Treatment of expenses incurred by persons who have an interest in the building.* For purposes of the substantial rehabilitation test in paragraph (b)(2)(i) of this section, the taxpayer may take into account qualified rehabilitation expenditures incurred during the same rehabilitation process by any other person who has an interest in the building. Thus, for example, to determine whether a building has been substantially rehabilitated a lessee may include the expenditures of the lessor and of other lessees; a condominium owner may include the expenditures incurred by other condominium owners; and an owner may include the expenditures of the lessees.

(vii) *Special rules when qualified rehabilitation expenditures are treated as incurred by the taxpayer.* In the case where qualified rehabilitation expenditures are treated as having been incurred by a taxpayer under paragraph (c)(3)(ii) of this section, the transferee shall be treated as having incurred the expenditures incurred by the transferor on the date that the transferor incurred the expenditures within the meaning of paragraph (c)(3)(i) of this section. For purposes of the substantial rehabilitation test in paragraph (b)(2)(i) of this

section, the transferee's adjusted basis in the building shall be determined as of the beginning of the first day of a 24-month period, or the first day of the transferee's holding period, whichever is later, as provided in paragraph (b)(2)(ii) of this section. The transferee's basis as of the first day of the transferee's holding period for purposes of the substantial rehabilitation test in paragraph (b)(2)(i) of this section, however, shall be considered to be equal to the transferee's basis in the building on such date less—

(A) The amount of any qualified rehabilitation expenditures incurred (or treated as having been incurred) by the transferor during the 24-month period that are treated as having been incurred by the transferee under paragraph (c)(3)(ii) of this section, and

(B) The amount of qualified rehabilitation expenditures incurred before the transfer and during the 24-month period by any other person who has an interest in the building (*e.g.*, a lessee of the transferor).

The preceding sentence shall not apply, however, unless the transferee's basis in the building is determined with reference to *(1)* the transferee's cost of the building (including the rehabilitation expenditures), *(2)* the transferor's basis in the building (where such basis includes the amount of the expenditures), and *(3)* any other amount that includes the cost of the rehabilitation expenditures. In the event that the transferee's basis is determined with reference to an amount not described above (*e.g.*, transferee's basis in one building is determined with reference to the transferee's basis in another building under section 1031(d)), the amount of the expenditures incurred by the transferor and treated as having been incurred by the transferee are not deducted from the transferee's basis for purposes of the substantial rehabilitation test. If the transferee's basis is determined under section 1014, any expenditures incurred by the decedent within the measuring period that are treated as having been incurred by the transferee under paragraph (c)(3)(ii) of this section shall increase the transferee's basis for purposes of the substantial rehabilitation test.

(viii) *Statement of adjusted basis, measuring period, and qualified rehabilitation expenditures.* In the case of any tax return filed after August 27, 1985 on which an investment tax credit for property described in section 48(a)(1)(E) is claimed, the taxpayer shall indicate by way of a marginal notation on, or a supplemental statement attached to, Form 3468—

(A) The beginning and ending dates for the measuring period selected by the taxpayer under section 48(g)(1)(C)(i) and paragraph (b)(2) of this section,

(B) The adjusted basis of the building (within the meaning of paragraph (b)(2)(iii) or (vii) of this section) as of the beginning of such measuring period, and

(C) The amount of qualified rehabilitation expenditures incurred, and treated as incurred, respectively, during such measuring period.

Furthermore, for returns filed after August 27, 1985, if the adjusted basis of the building for purposes of the substantial rehabilitation test is determined in whole or in part by reference to the adjusted basis of a person, or persons, other than the taxpayer, (*e.g.*, a rehabilitation by a lessee), the taxpayer must attach to the Form 3468 filed with the tax return on which the credit is claimed a statement addressed to the District Director, signed by such third party, that states the first day of the third party's holding period and the amount of the adjusted basis of such third party in the building at the beginning of the measuring period ro the first day of the holding period, whichever is later. If the taxpayer is unable to obtain the required information, that fact should be indicated and the taxpayer should state the fair market value of the building on the proper date.

(ix) *Examples.* The following examples illustrate the application of the substantial rehabilitation test in this paragraph (b)(2):

Example (1). Assume that A, a calendar year taxpayer, purchases a building for $140,000 on January 1, 1982, incurs qualified rehabilitation expenditures in the amount of $48,000 (at the rate of $4,000 per month) in 1982, $100,000 in 1983, and $20,000 (at the rate of $2,000 per month) in the first ten months of 1984, and places the rehabilitated building in service on October 31, 1984. Assume that A did not have written architectural plans and specifications describing a phased rehabilitation within the meaning of paragraph (b)(2)(v) of this section in existence prior to the beginning of physical work on the rehabilitation. For purposes of the substantial rehabilitation test in paragraph (b)(2) of this section, A may select any 24-consecutive-month measuring period that ends in 1984, the taxable year in which the rehabilitated building was placed in service. Assume that on A's 1984 return, A selected a measuring period beginning on February 1, 1982, and ending on January 31, 1984, and specifies that A's basis in the building (within the meaning of section 1011(a)) was $144,000 on February 1, 1982 ($140,000 + $4,000). (Thus $4,000 of rehabilitation expenditures incurred during January 1982 are included in A's basis under section 1011 even though such property has not been placed in service.) The amount of qualified rehabilitation expenditures incurred during the measuring period was $146,000 ($44,000 from February 1, to December 31, 1982, plus $100,000 in 1983, plus $2,000 in January 1984). The building shall be treated as "substantially rehabilitated" within the meaning of this paragraph (b)(2) for A's 1984 taxable year because the $146,000 of expenditures incurred by A during the measuring period exceeded A's adjusted basis of $144,000 at the beginning of the period. If the other requirements of section 48(g)(1) and this paragraph are met, the building is treated as a qualified rehabilitated building, and A can treat as qualified rehabilitation expenditures the amount of $168,000 (*i.e.*, $146,000 of expenditures incurred during the measuring period, $4,000 of expenditures incurred prior to the beginning of the measuring period as part of the rehabilitation process, and $18,000 of expenditures incurred after the measuring period during the taxable year within which the measuring period ends (see paragraph (c)(6) of this section)). The result would be the same if the property attributable to the rehabilitation expenditures was placed in service as the expenditures were incurred. (See paragraph (f)(2) of this section.)

Example (2). Assume the same facts as in example (1), except that additional rehabilitation expenditures are incurred after the rehabilitated building was placed in service on October 31, 1984. Such expenditures are incurred through the end of 1984 and in 1985 when the porton of the basis attirbutable to the additional expenditures is placed in service. The fact that the building qualified as a substantially rehabilitated building for A's 1984 taxable year has no effect on whether the building is a qualified rehabilitated building for property placed in service in A's 1985 taxable year. In order to determine whether the building is a qualified rehabilitated building for A's 1985 taxable year, A must select a measuring period that ends in 1985 and compare the expenditures incurred within that period with the adjusted basis as of the beginning of the period. Solely for the purpose of determining whether the building was substantially rehabilitated for A's 1985 taxable year, expenditures incured during 1983 and 1984, even though considered in determining whether the building was substantially rehabilitated in 1984, may also be used to determine whether the building was substantially rehabilitated for A's 1985 taxable year, provided the expenditures were incurred during any 24-month measuring period selected by A that ends in 1985.

Example (3). (i) Assume that B purchases a building for $100,000 on January 1, 1982, and leass the building to C who rehabilitates the

ding. Assume that C, a calendar year tax-r. places the property with respect to which bilitation expenditures were made in service 982 and selects December 31, 1982, as the of the measuring period for purposes of the antial rehabilitation test. The beginning of measuring period is January 2, 1982, the be-ing of B's holding period under section (e), and the adjusted basis of the building is ,000. Accordingly, if C incurred more than ,000 of qualified rehabilitation expenditures g 1982, the building would be substantially bilitated within the meaning of paragraph)(i) of this section.

) Assume the facts of example (3)(i), except after C begins physical work on the rehabili-, but before C incurs $100,000 of expendi-. D acquires the building, subject to C's from B for $200,000. D's holding period section 1250(e) begins on the day after D red the building, and C's adjusted basis for ses of the substantial rehabilitation test is ,000, less the amount of expenditures red by C before the transfer. (See paragraph (ii) and (vii) of this section.) Accordingly, incurred more than $200,000 (less the nt of expenditures incurred prior to the er) of qualified rehabilitation expenditures g 1982, the building would be substantially bilitated within the meaning of paragraph) of this section. Under paragraph)(ii)(B) of this section, however, C's ad-l basis for purposes of the substantial reha-ion test would be $100,000 if C had sub-ally rehabilited the building (*i.e.*, incurred than $100,000 in rehabilitation expendi-prior to B's sale to D.

mple (4). E owns a building with a basis of 00) and E incurs $5,000 of rehabilitation ex-itures. Before completing the rehabilitation t, E sells the building to F for $30,000. As-that F is treated under paragraph (c)(3)(ii) s section as having incurred the $5,000 of bilitation expenditures actually incurred by ecause F's basis in the building is deter-l under section 1011 with reference to F's 00 cost of the building (which includes the nt attributable to E's rehabilitation expend-). F's basis for purposes of the substantial bilitation test is $25,000 ($30,000 cost basis 5,000 rehabilitation expenditures treated as urred by F). (See paragraph (b)(2)(vii) of ection.) F would thus be required to incur than $20,000 of rehabilitation expenditures ddition to the $5,000 incurred by E and d as having been incurred by F) during a ring period selected by F to satisfy the sub-l rehabilitation test.

mple (5). G owns Building I with a basis of 00 and a fair market value of $20,000. H Building II with a basis of $5,000 and a fair t value of $20,000, with respect to which H ncurred $1,000 of rehabilitation expendi-. G and H exchange their buildings in a ction that qualifies for nonrecognition treat-under section 1031. Assume that G is d under paragraph (c)(3)(ii) of this section ving incurred $1,000 of rehabilitation ex-ures. G's basis in Building II is not deter-with reference to (A) the cost of Building H's basis in Building II (including the cost rehabilitation expenditures) or (C) any amount that includes the cost of the expend-but is instead determined with reference to G's basis in other property (Building I). Therefore, G's basis in Building II for purposes of the substantial rehabilitation test is not reduced by the $1,000 of rehabilitation expenditures treated as if occurred by G. (See paragraph (b)(2)(vii) of this section.) Accordingly, G's basis in Building II for purposes of the substantial rehabilitation test is $10,000, and G must incur additional rehabilitation expenditures in excess of $9,000 within a measuring period selected by G to satisfy the test.

(3) *Retention of 75 percent of external walls*—(i) *In general.* A building meets the requirement set forth in paragraph (b)(1)(iii) of this section if 75 percent or more of the existing external walls of the building (as measured by the total area of the existing external walls) are retained in place as external walls in the rehabilitation process. For this purpose, the area of existing external walls includes the area of windows and doors. If an addition to a building is not treated as part of a qualified rehabilitated building because it does not meet the 30-year requirement in paragraph (b)(4) of this section, then the external walls of such addition shall not be existing external walls of the building for purposes of section 48(g)(3)(A)(iii) and this section. The area of the existing external walls of a building shall be determined prior to any destruction, modification, or construction of walls that is undertaken by any party in anticipation of the rehabilitation.

(ii) *Alternative test described in section 48(g)(1)(E).* [Reserved]

(iii) *Definition of external wall.* For purposes of this paragraph (b), a wall includes both the supporting elements of the wall and the nonsupporting elements (*e.g.*, a curtain) of the wall. Except as otherwise provided in this paragraph (b)(3), the term "external wall" includes any wall that has one face exposed to the weather, earth, or an abutting wall of an adjacent building. The term "external wall" also includes a shared wall (*i.e.*, a single wall shared with an adjacent building), generally referred to as a "party wall," provided that the shared wall has no windows or doors in any portion of the wall that does not have one face exposed to the weather, earth, or an abutting wall. In general, the term "external wall" includes only those external walls that form part of the perimeter of the building or that surround an uncovered courtyard. Therefore, the walls of an uncovered internal shaft, designed solely to bring light or air into the center of building, which are completely surrounded by external walls of the building and which enclose space not designated for occupancy or other use by people (other than for maintenance or emergency), are not considered external walls. Thus, for example, a wall of a light well in the center of a building is not an external wall. However, walls surrounding an outdoor space which is usable by people, such as a courtyard, are external walls.

(iv) *Retained in place.* An existing external wall is retained in place if the supporting elements of the wall are retained inplace. An existing external wall is not retained in place if the supporting elements of the wall are replaced by new supporting elements. An external wall is retained in place, however, if the supporting elements are reinforced in the rehabilitation, provided that such supporting elements of the external wall are retained in place. An external wall also is retained in place if it is covered (*e.g.*, with new siding). Moreover, an external wall is retained in place if the existing curtain is replaced with a new curtain, provided that the structural framework that provides for the support of the existing curtain is retained in place. An external wall is retained in place notwithstanding that the existing doors and windows in the wall are modified, eliminated, or replaced. An external wall is retained in place if the wall is disassembled and reassembled, provided the same supporting elements are used when the wall is reassembled and the configuration of the external walls of the building after the rehabilitation is the same as it was before the rehabilitation process commenced. Thus, for example, a brick wall is considered retained in place even though the original bricks are removed (for cleaning, *etc.*) and replaced to form the wall.

(v) *Effect of additions.* If an existing external wall is converted into an internal wall (*i.e.*, a wall that is not an external wall), the wall is not retained in place as an external wall for purposes of this section.

(vi) *Examples.* The provisions of this paragraph (b)(3) may be illustrated by the following examples:

Example (1). Taxpayer A rehabilitated a building all of the walls of which consisted of wood

siding attached to gypsum board sheets (which covered the supporting elements of the wall, *i.e.*, studs). A covered the existing wood siding with aluminum siding as part of a rehabilitation that otherwise qualified under this subparagraph. The addition of the aluminum siding does not affect the status of the existing external walls as external walls and they would be considered to have been retained in place.

Example (2). Taxpayer B rehabilitated a building, the external walls of which had a masonry curtain. The masonry on the wall face was replaced with a glass curtain. The steel beam and girders supporting the existing masonry curtain were retained in place. The walls of the building are considered to be retained in place as external walls, notwithstanding the replacement of the curtain.

Example (3). Taxpayer C rehabilitated a building that has two external walls measuring 75′ × 20′ and two other external walls measuring 100′ × 20′. C demolished one of the larger walls, including its supporting elements and constructed a new wall. Because one of the larger walls represents more than 25 percent of the area of the building's external walls, C has not satisfied the requirement that 75 percent of the existing external walls must be retained in place as external walls.

Example (4). The facts are the same as in example (3), except that C does not tear down any walls, but builds an addition that results in one of the smaller walls becoming an internal wall. In addition, C enlarged 8 of the existing windows on one of the larger walls, increasing them from a size of 3′ × 4′ to 6′ × 8′. Since the smaller wall accounts for less than 25 percent of the total wall area, C has satisfied the requirement that 75 percent of the existng external walls must be retained in place as external walls in the rehabilitation process. The enlargement of the existing windows on the larger wall does not affect its status as an external wall.

Example (5). Taxpayer D rehabilitated a building that was in the center of a row of three buildings. The building being rehabilitated by D shares its side walls with the buildings on either side. The shared walls measure 100′ × 20′ and the rear and front walls measure 75′ × 20′. As part of a rehabilitation, D tears down and replaces the front wall. Because the shared walls as well as the front and back walls are considered external walls and the front wall accounts for less than 25 percent of the total external wall area (including the shared walls), D has satisfied the requirement that 75 percent of the existng external walls must be retained in place as external walls int he rehabilitation process.

(4) *Thirty-year requirement*—(i) *In general.* Except in the case of a certified historic structure (within the meaning of paragraph (d) of this section), a building is considered a qualified rehabilitated building only if a period of at least 30 years has elapsed between the date physical work on the rehabilitation of the building began and the date the building was first placed in service (within the meaning of §1.46-3(d)) as a building by any person.

(ii) *Additions.* A building that was first placed in service at least 30 years before physical work on the rehabilitation began will not be disqualified because additions to such building are less than 30 years old. Additions to the building that are less than 30 years old, however, shall not be treated as part of the qualified rehabilitated building. The term "addition" means any construction that resulted in any portion of an external wall becoming an internal wall, that resutled in an increase in the height of the building, or that increased the volume of the building.

(iii) *Vacant periods.* The 30-year period required by this paragraph (b)(3) includes periods during which a building was vacant or devoted to a personal use and is computed without regard to the number of owners or the identity of owners during the period.

(5) *Loction at which the rehabilitation occurs.* A building, other than a certified historic structure (within the meaning of paragraph (d) of this section), is not a qualified rehabilitated building unless it has been located where it is being rehabilitated for the thirty-year period immediately preceding the date physical work on the rehabilitation began in the case of a "30-year building" or the forty-year period immediately preceding the date physical work on the rehabilitation began in the case of a "40-year building." (See §1.46-1(q)(1) for the definitions of "30-year building" and "40-year building.")

(6) *Definition and special rule*—(i) *Physical work on a rehabilitation.* For purposes of this section, "physical work on a rehabilitation" begins when actual construction, or destruction in preparation for construction, begins. The term "physical work on a rehabilitation," however, does not include preliminary activities such as planning, designing, securing financing, exploring, researching, developing plans and specifications, or stabilizing a building to prevent deterioration (*e.g.*, placing boards over broken windows).

(ii) *Special rule for adjoining buildings that are combined.* For purposes of this paragraph (b), if as part of a rehabilitation process two or more adjoining buildings are combined and placed in service as a single building after the rehabilitation process, then, at the election of the taxpayer, all of the requirements for a qualified rehabilitation building in section 48(g)(1) and this section may be applied to the constituent adjoining buildings in the aggregate. For example, if such requirements are applied in the aggregate, any shared walls or abutting walls between the constituent buildings that would otherwise be treated as external walls (within the meaning of paragraph (b)(3) of this section) would not be treated as external walls of the building, and the substantial rehabilitation test in paragraph (b)(2) of this section would be applied to the aggregate expenditures with respect to all of the constituent buildings and to the aggregate adjusted basis of all of the constituent buildings. A taxpayer shall elect the special rule of this paragraph (b)(6)(ii) for adjoining buildings by indicating by way of a marginal notation on, or a supplemental statement attached to, the Form 3468 on which a credit is first claimed for qualified rehabilitation expenditures with respect to such buildings that such buildings are a single qualified rehabilitated building because of the application of the special rule in this paragraph (b)(6)(ii).

(c) *Definition of qualified rehabilitation expenditures*—(1) *In general.* Except as provided in paragraph (c)(7) of this section, the term "qualified rehabilitation expenditure" means any amount that is—

(i) Properly chargeable to capital account (as described in paragraph (c)(2) of this section),

(ii) Incurred by the taxpayer after December 31, 1981 (as described in paragraph (c)(3) of this section),

(iii) For recovery property that is real property (or additions or improvements to real property) with a recovery period (within a meaning of section 168) of 18 years (15 years for low-income housing) (as described in paragraph (c)(4) of this section), and

(iv) Made in connection with the rehabilitation of a qualified rehabilitated building (as described in paragraph (c)(5) of this section).

(2) *Chargeable to capital account.* For purposes of paragraph (c)(1) of this section, amounts are chargeable to capital account if they are properly includible in computing basis under §1.46-3(c). Amounts treated as an expense and deducted in the year they are

aid or incurred or amounts that are
nortized over a period of less than 18
ears (15 years in the case of low-
come housing) do not qualify. For
rposes of this paragraph (c), amounts
curred for architectural and engineer-
g fees, site survey fees, legal ex-
nses, insurance premiums, develop-
s fees, and other construction related
sts, if added to the basis of real prop-
y with a recovery period of 18 years
5 years in the case of low-income
using), satisfy the requirement of this
ragraph (c)(2). Construction period
erest and taxes, as defined in section
9, are not qualified rehabilitation ex-
nditures if they are amortized under
ction 189. If, however, the taxpayer
ects under section 266 to treat such
erest and taxes as chargeable to capi-
account with respect to real property
th a recovery period of 18 years (15
ars in the case of low-income hous-
g), they shall be treated in the same
nner as other costs described in this
ragraph (c)(2). Any construction pe-
d interest or taxes or other fees or
sts incurred in connection with the
quisition of land or a building are
bject to paragraph (c)(7)(ii) of this
ction.

(3) *Incurred by the taxpayer*—(i) *In
neral.* Qualified rehabilitation ex-
nditures are incurred by the taxpayer
purposes of this section on the date
ch expenditure would be considered
curred under the accrual method of
counting, regardless of the method of
counting used by the taxpayer with
spect to other items of income and
pense. If qualified rehabilitation ex-
nditures are treated as having been
curred by a taxpayer under paragraph
)(3)(ii) of this section, the taxpayer
ll be treated as having incurred the
penditures on the date such expendi-
es were incurred by the transferor.

(ii) *Qualified rehabilitation expendi-
es treated as incurred by the tax-
yer.* (A) Where rehabilitation ex-
nditures are incurred with respect to
uilding by a person (or persons)
ner than the taxpayer and the tax-
yer subsequently acquires the build-
g, or a position of the building to
ich the expenditures are allocable,
taxpayer acquiring such property
ll be treated as having incurred the
abilitation expenditures actually
urred by the transferor (or treated as incurred by the transferor under this paragraph (c)(3)(ii)) with respect to the acquired property, provided that—

(1) The building, or the portion of the building, acquired by the taxpayer was not used after the rehabilitation expenditures were incurred and prior to the date of acquisition, and

(2) No credit with respect to such qualified rehabilitation expenditures is claimed by anyone other than the taxpayer acquiring the property.

For purposes of this paragraph (c)(3)(ii), use shall mean actual use, whether personal or business.

(B) The amount of rehabilitation expenditures described in paragraph (c)(3)(ii)(A) of this section treated as incurred by the taxpayer under this paragraph shall be the lesser of—

(1) The amount of rehabilitation expenditures incurred before the date on which the taxpayer acquired the building (or portion thereof) to which the rehabilitation expenditures are attributable, or

(2) The portion of the taxpayer's cost or other basis for the property that is properly allocable to the property resulting from the rehabilitation expenditures described in paragraph (c)(3)(ii)(B)*(1)* of this section.

(C) For purposes of this paragraph (c)(3)(ii) of this section, the amount of rehabilitation expenditures treated as incurred by the taxpayer under this paragraph (c) shall not be treated as costs for the acquisition of a building. The portion of the cost of acquiring a building (or an interest therein) that is not treated under this paragraph as qualified rehabilitation expenditures incurred by the taxpayer is not treated as section 38 property in the hands of the acquiring taxpayer. (See paragraph (c)(7)(ii) of this section.) (See paragraph (b)(2)(vii) for rules concerning the application of the substantial rehabilitation test when expenditures are treated as incurred by the taxpayer.)

(iii) *Examples.* The provisions of this paragraph (c) may be illustrated by the following examples:

Example (1). In 1981, A, a taxpayer using the cash receipts and disbursements method of accounting, commenced the rehabilitation of a 30-year old building. In June 1981, A signed a contract with a plumbing contractor for replacement of the plumbing in the building. A agreed to pay the contractor as soon as the work was completed. The work was completed in December 1981, but A did not pay the amount due until January 15, 1982. The expenditures for the plumbing are not qualified rehabilitation expenditures (within the meaning of paragraph (c) of this section) because they were not incurred under the accrual method of accounting after December 31, 1981.

Example (2). B incurred qualified rehabilitation expenditures of $300,000 with respect to an existing building between January 1, 1982, and May 15, 1982, and then sold the building to C on June 1, 1982. The portion of the building to which the expenditures were allocable was not used by B or any other person during the period from January 1, 1982, to June 1, 1982, and neither B nor any other person claimed the credit. Consequently, C will be treated as having incurred the expenditures on the dates that B incurred the expenditures.

Example (3). C, a taxpayer using the cash receipts and disbursements method of accounting, begins the rehabilitation of a building on January 11, 1982. Prior to May 1, 1982, C pays rehabilitation expenditures of $12,000. On May 3, 1982, C sells the building, the land, and the property attributable to the rehabilitation expenditures to D for $35,000. The purchase price is properly allocable as follows:

land	$8,000
existing building	11,000
property attributable to rehabilitation expenditures	16,000
total purchase price	$35,000

The property attributable to the rehabilitation expenditures is placed in service by D on September 5, 1982. D may treat a portion of the $35,000 purchase price as rehabilitation expenditures paid or incurred by him. Since the rehabilitation expenditures paid by C ($12,000) are less than the portion of the purchase price properly allocable to property attributable to these expenditures ($16,000), D may treat only $12,000 as rehabilitation expenditures paid or incurred by him. The excess of the purchase price allocable to rehabilitation expenditures ($16,000) over the rehabilitation expenditures paid by C ($12,000), or $4,000, is treated as the cost of acquiring an interest in the building and is not a qualified rehabilitation expenditures treated a sincurred by D.

Example (4). The facts are the same as in example (3), except that the purchase price properly allocable to the property attributable to rehabilitation expenditures is $10,000. Under these circumstances, D may treat only $10,000 of C's $12,000 expenditures as rehabilitation expenditures paid by C. The excess of the rehabilitation expenditures paid by C ($12,000) over the purchase price allocable to rehabilitation expenditures ($10,000), or $2,000, is treated as the cost of acquiring an interest in the building and is not a qualified rehabilitation expenditure treated as incurred by D.

(4) *Incurred for 18-year property.* For purposes of this section, an expenditure is incurred for recovery property having a recovery period of 18 years only if the amount of the expenditure is added to the basis of property which is 18-year real property or 15-year real property in the case of low-income housing (within the meaning of section 168(c)). For purposes of

this section, the term "low-income housing" has the meaning given such term by section 168(c)(2)(F).

(5) *Made in connection with the rehabilitation of a qualified rehabilitation building.* In order to be qualified rehabilitation expenditures, expenditures must be incurred in connection with a rehabilitation as defined in paragraph (b)(2)(iv) of this section. Expenditures attributable to work done to facilities related to a building (*e.g.*, sidewalk, parking lot, landscaping) are not considered made in connection with the rehabilitation of a qualified rehabilitated building.

(6) *When expenditures may be incurred.* An expenditure is a qualified rehabilitation expenditure only if the building with respect to which the expenditures are incurred is substantially rehabilitated (within the meaning of paragraph (b)(2) of this section) for the taxable year in which the property attributable to the expenditures is placed in service (*i.e.*, the building is substantially rehabilitated during a measuring period ending with or within the taxable year in which the credit is claimed). (See paragraph (f)(2) of this section for rules relating to when property is placed in service.) The amount of qualified rehabilitation expenditures is limited to expenditures incurred:

(i) Before a measuring period, during which the building was substantially rehabilitated, that ends with or within the taxable year, provided that the expenditures were incurred in connection with the rehabilitation process that resulted in the substantial rehabilitation of the building;

(ii) Within a meaning period, during which the building was substantially rehabilitated, that ends with or within the taxable year, and

(iii) After a measuring period, during which the building was substantially rehabilitated, but prior to the end of the taxable year with or within which the measuring period ends.

(7) *Certain expenditures excluded from qualified rehabilitation expenditures.* The term "qualified rehabilitation expenditures" does not include the following expenditures:

(i) Any expenditure with respect to which an election is not made under section 168(b)(3) to use the straight-line method of depreciation. (See paragraph (c)(8) of this section.)

(ii) The cost of acquiring a building, any interest in a building (including a leasehold interest), or land, except as provided in paragraph (c)(3)(ii) of this section.

(iii) Any expenditure attributable to an enlargement of a building (within the meaning of paragraph (c)(9) of this section).

(iv) Any expenditure attributable to the rehabilitation of a certified historic structure or a building located in a registered historic district, unless the rehabilitation is a certified rehabilitation. (Paragraph (d) of this section contains definitions and special rules applicable to rehabilitations of certified historic structures and buildings located in registered historic districts.)

(v) Any expenditure of a lessee of a building if, on the date the rehabilitation is completed, the remaining term of the lease (determined without regard to any renewal period) is less than 18 years.

(vi) Any expenditure allocable to that portion of a building which is (or may reasonably be expected to be) tax-exempt use property (within the meaning of section 168(j) and the regulations thereunder), except that the exclusion in this paragraph (c)(7)(vi) shall not apply for purposes of determining whether the building is a substantially rehabilitated building under paragraph (b)(2) of this section.

(8) *Election to use straight-line cost recovery.* The requirement in section 48(g)(2)(B)(i) and paragraph (c)(7)(i) of this section that an election be made to use straight-line cost recovery applies only to the cost recovery of the portion of the basis of a qualified rehabilitated building that is attributable to qualified rehabilitation expenditures. See section 168(f)(1) for rules relating to the use of different methods of cost recovering for different components of a building. In addition, the requirement in section 48(g)(2)(B)(i) and paragraph (c)(7)(i) of this section shall not apply to any expenditure to the extent that section 168(f)(12) or (j) applies to such expenditure.

(9) *Enlargement defined*—(i) *In general.* A building is enlarged to the extent that the total volume of the building is increased. An increase in floor space resulting from interior remodelling is not considered an enlargement. The total volume of a building is generally equal to the product of the floor area of the base of the building and the height from the underside of the lowest floor (including the basement) to the average height of the finished roof (as it exists or existed). For this purpose, floor area is measured from the exterior faces of external walls (other than shared walls that are external walls) and from the centerline of shared walls that are external walls.

(ii) *Rehabilitation that includes enlargement.* If expenditures for property only partially qualify as qualified rehabilitation expenditures because some of the expenditures are attributable to the enlargement of the building, the expenditures must be apportioned between the original portion of the building and the enlargement. The expenditures must be specifically allocated between the original portion of the building and the enlargement to the extent possible. If it is not possible to make a specific allocation of the expenditures, the expenditures must be allocated to each portion on some reasonable basis. The determination of a reasonable basis for an allocation depends on factors such as the type of improvement and how the improvement relates functionally to the building. For example, in the case of expenditures for an air-conditioning system or a roof, a reasonable basis for allocating the expenditures among the two portions generally would be the volume of the building, excluding the enlargement, served by the air-conditioning system or the roof, relative to the volume of the enlargement served by the improvement.

(d) *Rules applicable to rehabilitations of certified historic structures*—(1) *Definition of certified historic structure.* The term "certified historic structure" means any building (and its structural components) that is—

(i) Listed in the National Register of Historic Places ("National Register"); or

(ii) Located in a registered historic district and certified by the Secretary of the Interior to the Internal Revenue Service as being of historic significance to the district.

(2) *Defintion of registered historic*

district. The term "registered historic district" means any district that is—

(i) Listed in the National Register, or

(ii) (A) Designated under a statute of the appropriate State or local government that has been certified by the Secretary of the Interior to the Internal Revenue Service as containing criteria that will substantially achieve the purpose of preserving and rehabilitating buildings of historic significance to the district, and (B) certified by the Secretary of the Interior as meeting substantially all of the requirements for the listing of districts in the National Register.

(3) *Definition of certified rehabilitation*. The term "certified rehabilitation" means any rehabilitation of a certified historic structure that the Secretary of the Interior has certified to the Internal Revenue Service as being consistent with the historic character of the building or the district in which such building is located. The determination of the scope of a rehabilitation shall be made on the basis of all the facts and circumstances surrounding the rehabilitation and shall not be made solely on the basis of ownership. The Secretary of the Interior shall take all of the rehabilitation work performed as part of a single rehabilitation, including any post-certification work, into account in determining whether the rehabilitation complies with the Department of Interior standards for rehabilitation and whether the certification should be granted, revoked, or otherwise invalidated.

(4) *Revoked or invalidated certification*. If the Department of Interior revokes or otherwise invalidates a certification after it has been issued to a taxpayer, the basis attributable to rehabilitation of the decertified property shall cease to be section 38 property described in section 48(a)(1)(E). Such cessation shall be effective as of the date the activity giving rise to the revocation or invalidation commenced. See section 47 for the rules applicable to property that ceases to be section 38 property.

(5) *Special rule for certain buildings located in registered historic districts*. The exclusion in paragraph (c)(7)(iv) of this section does not apply to a building in a registered historic district if—

(i) Such building was not a certified historic structure; and

(ii) The Secretary of the Interior certified to the Internal Revenue Service that such building was not of historic significance to the district.

If the certification referred to in paragraph (d)(5)(ii) of this section is requested by the taxpayer after physical work on the rehabilitation of the building has begun and is granted by the Secretary of the Interior, the taxpayer must certify to the Internal Revenue Service that, at the beginning of such rehabilitation, the taxpayer in good faith was not aware of the requirement of paragraph (d)(5)(ii) of this section. The certification referred to in the previous sentence must be attached to the Form 3468 filed with the tax return for the year in which the credit is claimed.

(6) *Special rule for certain rehabilitations begun before an area is designated as a registered historic district*. In general, paragraph (c)(7)(iv) of this section applies to any rehabilitation expenditures that are incurred after a building becomes a certified historic structure within the meaning of section 48(g)(3)(A) and paragraph (d)(1) of this section or the area in which a building is located becomes a registered historic district within the meaning of section 48(g)(3)(B) and paragraph (d)(2) of this section. Rehabilitation expenditures made after the date the area in which a building is located becomes a registered historic district, however, shall not be disqualified under paragraph (c)(7)(iv) of this section in any case in which physical work on the rehabilitation of a building begins prior to the date the taxpayer knows or has reason to know of an intention to nominate the area in which such building is located as a registered historic district. For purposes of this paragraph (d)(6), the taxpayer knows or has reason to know of such an intention if there is (A) a written communication to the owner of any building within the district that the district in which the building is located is being considered for designation as a registered historic district, (B) a legal notice of such consideration published in a newspaper, or (C) a public meeting held to discuss such consideration. In order to take advantage of the special rule of this paragraph (d)(6), the taxpayer must attach to the Form 3468 filed for the taxable year in which the credit is claimed, a statement that the taxpayer in good faith did not know, or have reason to know, of an intention to nominate the area in which the building is located as a registered historic district.

(7) *Notice of certification*—(i) *In general*. Except as otherwise provided in paragraph (d)(7)(ii) of this section, a taxpayer claiming the credit for rehabilitation of a certified historic structure (within the meaning of section 48(g)(3) and paragraph (d)(1) of this section) must attach to the Form 3468 filed with the tax return for the taxable year in which the credit is claimed a copy of the final certification of completed work by the Secretary of the Interior.

(ii) *Late certification*. If the final certification of completed work has not been issued by the Secretary of the Interior at the time the tax return is filed for a year in which the credit is claimed, a copy of the first page of the Historic Preservation Certification Application—Part 2—Description of Rehabilitation (NPS Form 10-168a), with an indication that it has been received by the Department of the Interior or its designate, must be attached to the Form 3468 filed with the return. A notice from the Department of the Interior or the State Historic Preservation Officer, stating that the application has been received, or a date-stamped application shall be sufficient indication that the application has been received. The taxpayer must submit a copy of the final certification as an attachment to Form 3468 with the first income tax return filed after the receipt by the taxpayer of the certification. If the final certification is denied by the Department of Interior, the credit will be disallowed for any taxable year in which it was claimed. If the taxpayer fails to receive final certification of completed work prior to the date that is 30 months after the date that the taxpayer filed the tax return on which the credit was claimed, the taxpayer must submit a written statement to the District Director stating such fact prior to the last day of the 30th month, and the taxpayer shall be requested to consent to an agreement under section 6501(c)(4) extending the period of assessment for any tax relating to the time for which the credit was claimed.

(e) *Adjustment to basis*—(1) *General rule.* If a credit is allowed with respect to qualified rehabilitation expenditures incurred in connection with a qualified rehabilitated building (other than a certified historic structure), the increase in the basis of the rehabilitated property that would otherwise result from the qualified rehabilitation expenditures must be reduced by the amount of credit allowed. If a rehabilitation investment credit is allowed with respect to qualified rehabilitation expenditures in connection with the rehabilitation of a certified historic structure, the increase in the basis of the rehabilitated property that would otherwise result from the qualified rehabilitation expenditures must be reduced by one-half of the amount of the credit allowed. See section 48 (q) for other rules concerning adjustments to basis in the case of section 38 property.

(2) Recapture of rehabilitation investment credit. If during any taxable year there is a recapture amount determined with respect to any credit that resulted in a basis adjustment under paragraph (e)(1) of this section, the basis of such building (immediately before the event resulting in such recapture) shall be increased by an amount equal to such recapture amount. For purposes of the preceding sentence, the term "recapture amount" means any increase in tax (or adjustment in carrybacks or carryovers) determined under section 47(a)(5).

(f) *Coordination with other provisions of the Code*—(1) *Credit claimed by lessee for rehabilitation performed by lessor.* A lessee may take the credit for rehabilitation performed by the lessor if the requirements of this section and section 48(d) are satisfied. For purposes of applying section 48(d), the fair market value of section 38 property described in section 48(a)(1)(E) shall be limited to that portion of the lessor's basis in the qualified rehabilitated building that is attributable to qualified rehabilitation expenditures.

(2) *When the credit may be claimed*—(i) *In general.* The investment credit for qualified rehabilitation expenditures is generally allowed in the taxable year in which the property attributable to the expenditure is placed in service, provided the building is a qualified rehabilitated building for the taxable year. See paragraph (b) of this section and section 46(c) and §1.46-3(d). Under certain circumstances, however, the credit may be available prior to the date the property is placed in service. See section 46(d) and §1.46-5 (relating to qualified progress expenditures). Solely for purposes of section 46(c), property attributable to qualified rehabilitation expenditures will not be treated as placed in service until the building with respect to which the expenditures are made meets the definition of a qualified rehabilitated building (as defined in section 48(g)(1) and paragraph (b) of this section) for the taxable year. Accordingly, in the first taxable year for which the building becomes a qualified rehabilitated building, the property described in section 48(a)(1)(E) attributable to expenditures described in paragraph (c) of this section shall be considered to be placed in service, if such property was considered placed in service under section 46(c) and the regulations thereunder without regard to this subparagraph in that taxable year or a prior taxable year. For purposes of the proceding sentence, the requirement in section 48(g)(1)(A)(iii) and paragraph (b)(3) of this section relating to the definition of a qualified rehabilitated building shall be deemed to be met if the taxpayer reasonably expects that no rehabilitation work undertaken during the remainder of the rehabilitation process wilsl result in less than 75 percent of the external walls being retained as external walls within the meaning of paragraph (b)(3) of this section. If more than 25 percent of the external walls of the building are not retained in place as external walls in the rehabilitation process, however, the credit shall be disallowed for the taxable year in which it was claimed. If a taxpayer fails to complete physical work on the rehabilitation prior to the date that is 30 months after the date that the taxpayer filed a tax return on which the credit is claimed, the taxpayer must submit a written statement to the District Director stating such fact prior to the last day of the 30th month, and shall be requested to consent to an agreement under section 6501(c)(4) extending the period of assessment for any tax relating to the item for which the credit was claimed.

(ii) *Example.* The application of this paragraph (f)(2) may be illustrated by the following example:

Example. Assume that A, a calendar year taxpayer, purchases a four-story building on January 1, 1983, for $100,000, and incurs $10,000 of qualified rehabilitation expenditures in 1983 to rehabilitate floor one, $50,000 of qualified rehabilitation expenditures in 1984 to rehabilitate floor two, $70,000 of qualified rehabilitation expenditures in 1985 to rehabilitate floor three, and $60,000 of qualified rehabilitation expenditures in 1986 to rehabilitate floor four. Assume further that A places the property attributable to these expenditures in service on the last day of the year in which the respective expenditures were incurred. Under the rule in this paragraph (f)(2), the portion of the basis of the building that is attributable to qualified rehabilitation expenditures incurred with respect to floor one and two are deemed to be placed in service in 1985, because that is the first year that the substantial rehabilitation test described in paragraph (b) of this section is met ($120,000 of expenditures incurred by A during a measuring period ending on December 31, 1985 is greater than the $110,000 basis at the beginning of the period). Assume that as of December 31, 1985, at least 75 percent of the external walls of the building have been retained during the rehabilitation process and that A has a reasonable expectation that no work during the remainder of the rehabilitation process will result in less than 75 percent of the external walls being retained. A may claim a credit for A's 1985 taxable year on $130,000 of qualified rehabilitation expenditures ($10,000 in 1983, $50,000 in 1984, and $70,000 in 1985). (See paragraph (c)(6) of this section for rules applicable to when qualified expenditures may be incurred. In addition, see section 46(d) and §1.46-5 for rules relating to qualified progress expenditures.) The fact that the building was a qualified rehabilitated building for A's 1985 taxable year, however, has no effect on whether the building is a qualified rehabilitated building for A's 1986 taxable year. In order to determine whether A is entitled to claim a credit on A's 1986 return for the $60,000 of qualified rehabilitation expenditures incurred in 1986, A must select a measuring period ending in 1986 and must determine whether the building is a qualified rehabilitated building for that year. Solely for purposes of determining whether the building was substantially rehabilitated, expenditures incurred in 1984 and 1985, even though considered in determining whether the building was substantially rehabilitated for A's 1985 taxable year, may be used in addition to the expenditures incurred in 1986 to determine whether the building was substantially rehabilitated for A's 1986 taxable year, provided the expenditures were incurred during any measuring period selected by A that ends in 1986.

(3) *Coordination with section 47.* If property described in section 48(a)(1)(E) is disposed of by the taxpayer, or otherwise ceases to be "section 38 property," section 47 may apply. Property will cease to be section 38 property, and therefore section 47 may apply, in any case in which the Department of Interior revokes or otherwise invalidates a certification of re-

habilitation after the property is placed in service. If, for example, the taxpayer made modifications to the building inconsistent with Department of Interior standards, the Secretary of the Interior might revoke the certification. In addition, if all or a portion of a substantially rehabilitated building becomes tax-exempt use property (see paragraph (c)(7)(vi) of this section) for the first time within five years after the credit is claimed, the credit will be recaptured under section 47 at that time as if the building or portion of the building which becomes tax-exempt use property had then been sold.

Par. 5. Section 1.191-1 is amended by revising paragraphs (a), (b)(1)(i) and (3), and (c)(2)(iii), and by adding a new paragraph (f) to read as follows:

§1.191-1 Amortization of certain rehabilitation costs for certified historic structures.

(a) *In general.* Section 191 allows an owner of a certified historic structure who rehabilitates the structure to elect to amortize over a 60-month period certain expenditures attributable to certified rehabilitation. The election may be made only if the certified historic structure (as defined in §1.191-1 (a)) and the improvements made are otherwise of a character subject to depreciation under section 167. In general, only those rehabilitation expenditures which result in additions to capital account after June 14, 1976, and before January 1, 1984, are eligible for this special amortization procedure. To qualify for the election, the rehabilitation must be certified by the Secretary of the Interior to the Internal Revenue Service as consistent with the historic character of the structure. See §1.191-2(d) for the definition of certified rehabilitation. Along with the amortization deductions, the taxpayer may continue otherwise allowable depreciation deductions of the basis of the structure, exclusive of rehabilitation costs which are a part of the amortizable basis (as defined in §1.191-2(e)).

(b) *Allowance of deduction*—(1) *Determination of amortization period*—(i) *General rule.* The taxpayer may elect to begin the 60-month amortization period with the month following the month in which the amortizable basis is acquired, or with the first month of the succeeding taxable year. Generally amortizable basis must be acquired after June 14, 1976, and before January 1, 1984. For purposes of this section, the month in which the amortizable basis is acquired is the latest of the month in which the work (or a component part of the work) is completed, the month in which costs are added to capital account, or the month in which depreciation deducations under section 167 would be first allowable with respect to the structure. See, however, §1.191-2(e)(8) for special rules for certified rehabilitations in part occurring outside the effective period of section 191. No amortization deduction may be claimed before a building is used (or held for use) in a trade or business or for the production of income.

* * * * *

(3) *Relation to section 167(o) and other provisions.* If an election involving a certified historic structure is made under section 191, no election may be made under section 167(o) either for the same rehabilitation or for any subsequent rehabilitation of the same structure undertaken by the taxpayer making an election under section 191. Additionally, no election is permitted under section 191 if depreciation deductions or credits against tax based upon any part of the costs qualifying for amortization under section 191, are at any time claimed (or allowable) under any depreciation or other provision of the Internal Revenue Code of 1954. However, this limitation with respect to investment tax credits under section 38 applies only to structures placed in service after October 31, 1978. Except as provided in paragraph (f)(3) of this section, if section 191 treatment is timely elected on a structure placed in service after October 31, 1978, the investment tax credit under section 38 is considered not to have been allowable with respect to that structure for the same rehabilitation. However, the rule in the preceding sentence does not preclude a taxpayer from claiming an investment tax credit with respect to a separate and distinct rehabilitation to a structure on which a section 191 election was previously made.

* * * * *

(c) *Person to claim deduction.* * * *

(2) *Exceptions and special rules.* * * *

(iii) *Certain transferees of historic structures.* If expenditures for certified rehabilitation are in fact made by the owner of a certified historic structure, and if one or more transferees then acquire the ownership of the rehabilitated directly from that owner before the structure is placed in service in its rehabilitated use, the transferees, solely for purposes of section 191, may be treated as having incurred the rehabilitation expenditures actually incurred by the transferor on the date that the transferor actually incurred those expenditures. Transferees acquiring structures in transfers occuring after the structure is placed in service after its rehabilitation but before the first day of the following taxable year, are not eligible for section 191 treatment, because depreciation deductions for rehabilitation costs are allowable to the transferor before the transfer. The amount of rehabilitation expenditures treated as made by the transferees under this subdivision (iii) is the lesser amount of—

(A) The rehabilitation expenditures actually made before the date on which the transferee acquired ownership of the structure, or

(B) The portion of the transferee's cost or other basis for the property (determined according to the rules of section 167) which is attributable to rehabilitation expenditures made before the date on which the transferee acquires ownership of the structure.

* * * * *

(f) *Termination*—(1) *In general.* Except as provided in paragraph (f)(2) of this section, section 191, this section, §1.191-2, and §1.191-3 shall not apply to expenditures incurred after December 31, 1981, in taxable years ending after such date.

(2) *Transition rule.* Section 191 and this section shall continue to apply to expenditures incurred after December 31, 1981, and before January 1, 1984, for the rehabilitation of a building if—

(i) The physical work on the rehabilitation began before January 1, 1982, and

(ii) The building does not meet the requirements of §1.48-12(b).

(3) *Coordination with section 38.* The fact that section 191 has been timely elected with respect to expenditures incurred prior to January 1, 1982, shall not prevent the investment tax

credit under section 38 from being allowed with respect to qualified rehabilitation expenditures (within the meaning of section 48(g)(2) and §1.48-12(c)) incurred after December 31, 1981, as part of the same rehabilitation.

Par. 6. Section 1.191-2 is amended by revising paragraph (e)(8) to read as follows:

§1.191-2 Definitions and special rules.

* * * * *

(e) *Amortizable basis.* * * *

(8) *Time when amounts are added to capital account.* Under section 191, expenditures are treated as added to capital account at the time they are actually made (paid or accrued). However, amortizable basis includes only expenditures attributable to component parts of the structure completed before January 1, 1984. Therefore, expenditures for improvements completed after December 31, 1983 are not a part of the taxpayer's amortizable basis even through they may have been paid or accrued prior to that date. In the case of a single and continuous rehabilitation project all of which is certified by the Secretary of the Interior, expenditures for rehabilitation begun before June 14, 1976, but completed and charged thereafter, are a part of the taxpayer's amortizable basis. However, even where there is a single and continuous rehabilitation project, expenditures made for any component part of the improvements completed and charged before June 14, 1976, are not a part of the taxpayer's amortizable basis.

Par. 7. Section 1.191-3 is amended by revising paragraph (b)(4) to read as follows:

§1.191-3 Time and manner of making election.

* * * * *

(b) *Special rules.* * * *

(4) *Elections to begin amortization deductions after December 31, 1983.* Notwithstanding the rules of §1.191-1(b)(1)(i), expenditures for component parts of a rehabilitation project which is not completed and placed in service until after December 31, 1983, are included in amortizable basis if the component parts are completed and the expenditures are added to capital account under §1.191-2(e)(8) by that date. Amortization deductions for the costs of such component parts are allowable beginning with the month in which the entire rehabilitation would qualify under §1.191-1(b)(1), but for the expiration of section 191 on December 31, 1983.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on June 27, 1985, 8:45 a.m., and published in the issue of the Federal Register for June 28, 1985, 50 F.R. 26794)

Notice of Proposed Rulemaking

Capital Gains Tax and Passive Investment Income Tax With Respect to Certain S Corporations

LR-267-82

SUMMARY: This document contains proposed regulations relating to a tax imposed on capital gains of certain S corporations and a tax imposed on the excess net passive income of certain S corporations that have accumulated earnings and profits from subchapter C years. Changes to the applicable law were made by the Subchapter S Revision Act of 1982 [Pub. L. 97-354, 1982-2 C.B. 702], as amended by the Technical Corrections Act of 1982 [Pub. L. 97-448, 1983-1 C.B. 451] and the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. The regulations would provide the public with the guidance needed to comply with the law as amended by these Acts.

DATE: Written comments and requests to comment orally at a public hearing must be delivered or mailed by September 3, 1985. The amendments under section 1374 are generally proposed to be effective for taxable years beginning after December 31, 1982, and the amendments under section 1375 are generally proposed to be effective for taxable years beginning after 1981.

ADDRESS: Send comments and requests to comment orally at a public hearing to: Commissioner of Internal Revenue, ATTN: CC:LR:T (LR-267-82), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: John G. Schmalz of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224 (Attn: CC:LR:T) (202-566-3516, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 1374 and 1375 of the Internal Revenue Code of 1954. Generally, these proposed regulations are proposed to conform the Income Tax Regulations to section 2 of the Subchapter S Revision Act of 1982 (96 Stat. 1669) [Pub. L. 97-354, 1982-2 C.B. 702-711], as amended by section 305(d)(3) of the Technical Corrections Act of 1982 (96 Stat. 2400) [Pub. L. 97-448, 1983-1 C.B. 451, 469] and sections 102(d)(1), 474(r), and 721(u) and (v) of the Tax Reform Act of 1984 (98 Stat. 623, 844, and 971) [1983-3 C.B. (Vol. 1) 1, 131, 347, 479].

IN GENERAL

Section 1374 imposes a tax on the capital gains of certain S corporations. The tax is imposed for any taxable year in which the S corporation has a net capital gain in excess of $25,000 for the taxable year if the amount of the net capital gain exceeds 50 percent of the taxable income for such year and the taxable income for such year is in excess of $25,000.

The amount of the tax is generally 28 percent of the amount of the net capital gain in excess of $25,000. However, in no case will the tax imposed by section 1374 on the corporation exceed the tax that would have been imposed by section 11 on the corporation if the corporation were not an S corporation. Section 1374(c) contains exceptions to the tax imposed by section 1374(a) and a special rule in the case of property with a substituted basis. Section 1374(d) and §1.1374A-1(d) define the term "taxable income" for purposes of section 1374.

Section 1375 imposes a tax on the excess net passive income of certain S corporations that have subchapter C earnings and profits. The tax can generally be avoided by the corporation distributing its subchapter C earnings and profits before the close of the taxable year. The tax is computed by multiplying the excess net passive income by the highest rate of tax specified in sec-

tion 11(b). Section 1375(b) and §1.1375A-1(b) define the term "excess net passive income." A special rule contained in section 1375(c) ensures that a net capital gain that is taken into account under section 1375 in computing the passive income tax will not also be taken into account in determining the capital gains tax under section 1374. Section 1375(d) provides that the tax imposed by section 1375 may be waived in certain limited cases where an S corporation determined in good faith that it had no subchapter C earnings and profits at the end of a taxable year and it is later determined that it did have such earnings and profits. Section 1.1375A-1(d) provides rules concerning this waiver.

COMMENTS AND PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. If one is requested, a public hearing will be held and a notice of time and place for the public hearing will be published in the FEDERAL REGISTER.

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

The Commissioner of Internal Revenue has determined that this proposed rule is not subject to a Regulatory Impact Analysis under Executive Order 12291 because under the Treasury-OMB agreement of April 29, 1983, it is not a major legislative regulation. Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Also, these regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of these proposed regulations is John G. Schmalz of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Proposed amendments to the regulations

The proposed amendments to 26 CFR Part 1 are as follows:

Paragraph 1. These regulations are issued under the authority of 26 U.S.C. 7805, and the authority citation for Part 1 remains unchanged.

Par. 2. Sections 1.1361-1 through 1.1361-16 are removed.

Par. 3. There are inserted immediately after §1.1348-3 the following new §§1.1361A-0, 1.1374A-1, and 1.1375A-1 to read as follows:

§1.1361A-0 Effective date.

(a) Except as otherwise provided in the regulations, the provisions of §§1.1374A-1 and 1.1375A-1 apply to taxable years beginning after December 31, 1982.

(b) The provisions of §§1.1371-1 through 1.1378-3 apply to a qualified casualty insurance electing small business corporation and to a qualified oil corporation for taxable years beginning after December 31, 1982, and the provisions of §§.1374A-1 and 1.1375A-1 shall not apply. See section 6(c)(2), (3), and (4) of the Subchapter S Revision Act of 1982 [Pub. L. 97-354, 1982-2 C.B. 702, 717].

§1.1374A-1 Tax imposed on certain capital gains.

(a) *General rule.* Except as otherwise provided in paragraph (c) of this section, if for a taxable year beginning after 1982 of an S corporation—

(1) The next capital gain of such corporation exceeds $25,000, and

(2) The net capital gain of such corporation exceeds 50 percent of its taxable income (as defined in paragraph (d) of this section) for such year, and

(3) The taxable income of such corporation (as defined in paragraph (d) of this section) for such year exceeds $25,000,

section 1374 imposes a tax (computed under paragraph (b) of this section) on the income of such corporation. The tax is imposed on the S corporation and not on the shareholders.

(b) *Amount of tax.* The amount of tax shall be the lower of—

(1) An amount equal to the tax, determined as provided in section 1201(a)(2), on the amount by which the net capital gain of the corporation for the taxable year exceeds $25,000, or

(2) An amount equal to the tax which would be imposed by section 11 on the taxable income of the corporation (as defined in paragraph (d) of this section) for the taxable year were it not an S corporation.

No credit shall be allowable under part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1954 (other than under section 34) against the tax imposed by section 1374(a) and this section. See section 1375(c)(2) and §1.1375A-1(c)(2) for a special rule that reduces the amount of the net capital gain of the corporation for purposes of this paragraph (b) in cases where a net capital gain is taxed as excess net passive income under section 1375. See section 1374(c)(3) and paragraph (c)(1)(ii) of this section for a special rule that limits the amount of tax on property with a substituted basis in certain cases.

(c) *Exceptions to taxation*—(1) *New corporations and corporations with election in effect for 3 immediately preceding years*—(i) *In general.* If an S corporation would be subject to the tax imposed by section 1374 for a taxable year pursuant to paragraph (a) of this section, the corporation shall, nevertheless, not be subject to such tax for such year, if:

(A) The election under section 1362(a) which is in effect with respect to such corporation for such year has

been in effect for the corporation's three immediately preceding taxable years, or

(B) An election under section 1362(a) has been in effect with respect to such corporation for each of its taxable years for which it has been in existence,

unless there is a net capital gain for the taxable year which is attributable to property with a substituted basis within the meaning of paragraph (c)(1)(iii) of this section.

(ii) *Amount of tax on net capital gain attributable to property with a substituted basis.* If for a taxable year of an S corporation either paragraph (c)(1)(i)(A) or (B) of this section is satisfied, but the S corporation has a net capital gain for such taxable year which is attributable to property with a substituted basis (within the meaning of paragraph (c)(1)(iii) of this section), then paragraph (a) of this section shall apply for the taxable year, but the amount of tax determined under paragraph (b) of this section shall not exceed a tax, determined as provided in section 1201(a), on the net capital gain attributable to property with a substituted basis.

(iii) *Property with substituted basis.* For purposes of this section, the term "property with a substituted basis" means:

(A) Property acquired by a corporation ("the acquiring corporation") during the period beginning 36 months before the first day of the acquiring corporation's taxable year and ending on the last day of such year;

(B) The basis of such property in the hands of the acquiring corporation is determined in whole or in part by reference to the basis of any property in the hands of another corporation; and

(C) Such other corporation was not an S corporation throughout the period beginning the later of:

(1) 36 months before the first day of the acquiring corporation's taxable year, or

(2) The time such other corporation came into existence,

and ending on the date such other corporation transferred the property, the basis of which is used to determine, in whole or in part, the basis of the property in the hands of the acquiring corporation.

(iv) *Existence of a corporation.* For purposes of this section, a corporation shall not be considered to be in existence for any taxable year which precedes the first taxable year in which such corporation has shareholders or acquires assets or begins business, whichever is first to occur.

(v) *References to prior law included.* For purposes of this paragraph (c), the term "S corporation" shall include an electing small business corporation under prior subchapter S law, and the term "election under section 1362(a)" shall include an election under section 1372 of prior subchapter S law.

(vii) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). M Corporation was organized and began business in 1977. M subsequently made an election under section 1362(a) which was effective for its 1984 taxable year. If such election does not terminate under section 1362 for its taxable years 1984, 1985, and 1986, M is not subject to the tax imposed by section 1374 for its taxable year 1987, or for any subsequent year for which such election remains in effect, unless it has, for any such year, an excess of net long-term capital gain over net short-term capital loss attributable to property with a substituted basis. If there is such an excess for any such year, and the requirements of paragraph (a) of this section are met, M will be subject to the tax for such year. If there is no such excess for any year after 1986, M will not be subject to the tax for any such year even though the requirements of paragraph (a) of this section are met.

Example (2). N corporation was organized in 1983, and was an S corporation for its first taxable year. N is not subject to the tax imposed by section 1374 for 1983, or for any subsequent year for which its original election under section 1362(a) has not terminated under section 1362(d), unless, for any such year, it has an excess of net long-term capital gain over net short-term capital loss attributable to property with a substituted basis and the requirements of paragraph (a) of this section are met.

(2) *Treatment of certain gains of options and commodities dealers*—(i) *Exclusion of certain capital gains.* For purposes of this section, the net capital gain of any options dealer or commodities dealer shall be determined by not taking into account any gain or loss (in the normal course of the taxpayer's activity of dealing in or trading section 1256 contracts) from any section 1256 contract or property related to such a contract.

(ii) *Definitions.* For purposes of this paragraph (c)(2)—

(A) *Options dealer.* The term "options dealer" has the meaning given to such term by section 1256(g)(8).

(B) *Commodities dealer.* The term "commodities dealer" means a person who is actively engaged in trading section 1256 contracts and is registered with a domestic board of trade which is designated as a contract market by the Commodities Futures Trading Commission.

(C) *Section 1256 contracts.* The term "section 1256 contracts" has the meaning given to such term by section 1256(b).

(iii) *Effective dates*—(A) *In general.* Except as otherwise provided in this paragraph (c)(2)(iii), this paragraph (c)(2) shall apply to positions established after July 18, 1984, in taxable years ending after such date.

(B) *Special rule for options on regulated futures contracts.* In the case of any option with respect to a regulated futures contract (within the meaning of section 1256), this paragraph (c)(2) shall apply to positions established after October 31, 1983, in taxable years ending after such date.

(C) *Elections with respect to property held on or before July 18, 1984.* See §§1.1256(h)-1T and 2T for rules concerning an election to have this paragraph (c)(2) apply to certain property held on or before July 18, 1984.

(d) *Determination of taxable income*— (1) *General rule.* For purposes of this section, taxable income of the corporation shall be determined under section 63(a) as if the corporation were a C corporation rather than an S corporation, except that the following deductions shall not apply in the computation—

(i) The deduction allowed by section 172 (relating to net operating loss deduction), and

(ii) The deductions allowed by part VIII of subchapter B (other than the deduction allowed by section 248, relating to organization expenditures).

For any taxable year in which a tax under this section is imposed on an S corporation, the S corporation shall attach a Form 1120 completed in accordance with this paragraph (d) to its tax return filed for such taxable year.

(2) *Special rule for net capital gain taxed as excess net passive income under section 1375.* See section 1375(c)(2) and §1.1375A-1(c)(2) for a special rule that reduces the taxable in-

come of the corporation for purposes of section 1374(b)(2) and §1.1374A-1(b)(2) in cases where a net capital gain is taxed as excess net passive income under section 1375.

(e) *Reduction in pass-thru for tax imposed on capital gain.* See section 1366(f)(2) for a special rule reducing the S corporation's long-term capital gains and the corporation's gain from sales or exchanges of property described in section 1231 for purposes of section 1366(a) by an amount of tax imposed under section 1374 and this section.

(f) *Examples.* The following examples illustrate the principles of this section and assume that a tax will not be imposed under section 1375:

Example (1). Corporation M is an S corporation for its taxable year beginning January 1, 1983. For 1983, M has an excess of net long-term capital gain over net short-term capital loss in the amount of $30,000. However, its taxable income for the year is only $20,000 as a result of other deductions in excess of other income. Thus, although the excess of the net long-term capital gain over the net short-term capital loss exceeds $25,000 and also exceeds 50 percent of taxable income, M is not subject to the tax imposed by section 1374 for 1983 because its taxable income does not exceed $25,000.

Example (2). Corporation N is an S corporation for its 1983 taxable year. For 1983, N has an excess of net long-term capital gain over net short-term capital loss in the amount of $30,000, and taxable income of $65,000. Thus, although N's net capital gain ($30,000) exceeds $25,000, it does not exceed 50 percent of the corporation's taxable income for the year (50 percent of $65,000, or $32,500), and therefore N is not subject to the tax imposed by section 1374 for such year.

Example (3). Assume that Corporation O, an S corporation, is subject to the tax imposed by section 1374 for its taxable year 1983. For 1983, O has an excess of net long-term capital gain over net short-term capital loss in the amount of $73,000, and taxable income within the meaning of section 1374, which includes capital gains and losses, of $100,000. The amount of tax computed under paragraph (b)(1) of this section is 28 percent of $48,000 ($73,000–$25,000), or $13,440. Since this is lower than the amount computed under paragraph (b)(2) of this section, which is $25,750 ($3,750 + $4,500 + $7,500 + $10,000), $13,440 is the amount of tax imposed by section 1374.

Example (4). Assume that in example (3) the taxable income of O for 1983 is $35,000. This results from an excess of deductions over income with respect to items which were not included in determining the excess of the net long-term capital gain over the net short-term capital loss. In such case, the amount of tax, computed under paragraph (b)(2) of this section, is $5,550. Since this is lower than the amount computed under paragraph (b)(1) of this section, $5,550 is the amount of tax imposed by section 1374.

Example (5). Corporation P, an S corporation, for its taxable year 1983 has an excess of net long-term capital gain over net short-term capital loss in the amount of $65,000 and has taxable income of $80,000. P's election under section 1362 has been in effect for its three immediately preceding taxable years, but P, nevertheless, is subject to the tax imposed by section 1374 for 1983 since it has an excess of net long-term capital gain over net short-term capital loss (in the amount of $20,000) attributable to property with a substituted basis. The tax computed under paragraph (b)(1) of this section, $11,200 (28 percent of $40,000 ($65,000–$25,000)), is less than the tax computed under paragraph (b)(2) of this section, $17,750. However, under the limitation provided in paragraph (c) of this section which is applicable in this factual situation, the tax imposed by section 1374 for 1983 may not exceed $5,600 (28 percent of $20,000, the excess of net long-term capital gain over net short-term capital loss attributable to property with a substituted basis).

§1.1375A-1 Tax imposed when passive investment income of corporation having subchapter C earnings and profits exceed 25 percent of gross receipts.

(a) *General rule.* For taxable years beginning after 1981, section 1375(a) imposes a tax on the income of certain S corporations that have passive investment income. In the case of a taxable year beginning during 1982, an electing small business corporation may elect to have the rules under this section not apply. See the regulations under section 1362 for rules on the election. For purposes of this section, the term "S corporation" shall include an electing small business corporation under prior law. This tax shall apply to an S corporation for a taxable year if the S corporation has—

(1) Subchapter C earnings and profits at the close of such taxable year, and

(2) Gross receipts more than 25 percent of which are passive investment income.

If the S corporation has no subchapter C earnings and profits at the close of the taxable year (because, for example, such earnings and profits were distributed in accordance with section 1368), the tax shall not be imposed even though the S corporation has passive investment income for the taxable year. If the tax is imposed, the tax shall be computed by multiplying the excess net passive income (as defined in paragraph (b) of this section) by the highest rate of tax specified in section 11(b).

(b) *Definitions*—(1) *Excess net passive income*— (i) *In general.* The term "excess net passive income" is defined in section 1375(b)(1), and can be expressed by the following formula:

$$ENPI = \frac{NPI \times PII - (.25 \times GR)}{PII}$$

where:

ENPI = excessive net passive income
NPI = net passive income
PII = passive investment income
GR = total gross receipts

(ii) *Limitation.* The amount of the excess net passive income for any taxable year shall not exceed the corporation's taxable income for the taxable year (determined in accordance with section 1374(d) and §1.1374A-1(d)).

(2) *Net passive income.* The term "net passive income" means—

(i) Passive investment income, reduced by

(ii) The deductions allowable under chapter 1 of the Internal Revenue Code of 1954 which are directly connected with the production of such income (other than deductions allowable under section 172 and part VIII of subchapter B).

For purposes of the preceding sentence, to be directly connected with the production of income, an item of deduction must have proximate and primary relationship to the income. Expenses, depreciation, and similar items attributable solely to such income qualify for deduction.

(3) *Other definitions.* The terms "subchapter C earnings and profits," "passive investment income," and "gross receipts" shall have the same meaning given these terms in section 1362(d)(3) and the regulations thereunder.

(c) *Special rules*—(1) *Disallowance of credits.* No credit is allowed under part IV of subchapter A of chapter 1 of the Code (other than section 34) against the tax imposed by section 1375(a) and this section.

(2) *Coordination with section 1374.* If any gain—

(i) Is taken into account in determining passive income for purposes of this section, and

(ii) Is taken into account under section 1374, the amount of such gain taken into account under section 1374(b) and §1.1374A-1(b)(1) and (2) in determining the amount of tax shall

be reduced by the portion of the excess net passive income for the taxable year which is attributable (on a pro rata basis) to such gain. For purposes of the preceding sentence, the portion of excess net passive income for the taxable year which is attributable to such capital gain is equal to the amount determined by multiplying the excess net passive income by the following fraction:

$$\frac{NCG}{NPI}$$

Where:

NCG = net capital gain
NPI = net passive income

(d) *Waiver of tax in certain cases*—(1) *In general.* If an S corporation establishes to the satisfaction of the Commissioner that—

(i) It determined in good faith that it had no subchapter C earnings and profits at the close of the taxable year, and

(ii) During a reasonable period of time after it was determined that it did have subchapter C earnings and profits at the close of such taxable year such earnings and profits were distributed,

the Commissioner may waive the tax imposed by section 1375 for such taxable year. The S corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should waive the tax. For example, if an S corporation establishes that in good faith and using due diligence it determined that it had no subchapter C earnings and profits at the close of a taxable year, but it was later determined on audit that it did have subchapter C earnings and profits at the close of such taxable year, and if the corporation establishes that it distributed such earnings and profits within a reasonable time after the audit, it may be appropriate for the Commissioner to waive the tax on passive income for such taxable year.

(2) *Corporation's request for waiver.* A request for waiver of the tax imposed by section 1375 shall be made in the form of a ruling request and shall contain all relevant facts to establish that the requirements of paragraph (d)(1) of this section are met. Such request shall contain a description of how and on what date the S corporation in good faith and using due diligence determined that it had no subchapter C earnings and profits at the close of the taxable year, a description of how and on what date it was determined that the S corporation had subchapter C earnings and profits at the close of the year and a description (including dates) of any steps taken to distribute such earnings and profits. If the earnings and profits have not yet been distributed, the request shall contain a timetable for distribution and an explanation of why such timetable is reasonable. On the date the waiver is to become effective, all subchapter C earnings and profits must have been distributed. Send requests for a waiver to: Internal Revenue Service, Associate Chief Counsel (Technical), Attention: CC:IND:S, 1111 Constitution Ave., N.W., Washington, D.C. 20224.

(e) *Reduction in pass-thru for tax imposed on excess net passive income.* See section 1366(f)(3) for a special rule reducing each item of the corporation's passive investment income for purposes of section 1366(a) if a tax is imposed on the corporation under section 1375.

(f) *Example.* The following example illustrates the principles of this section:

Example. Assume Corporation M, an S corporation, has for its taxable year total gross receipts of $200,000, passive investment income of $100,000, $60,000 of which is interest income, and expenses directly connected with the production of such interest income in the amoung of $10,000. Assume also that at the end of the taxable year Corporation M has subchapter C earnings and profits. Since more than 25 percent of Corporation M's total gross receipts are passive investment income, and since Corporation M has subchapter C earnings and profits at the end of the taxable year, Corporation M will be subject to the tax imposed by section 1375. The amount of excess net passive investment income is $45,000 ($90,000 × (50,000/100,000)). Assume that the other $40,000 of passive investment income is attributable to net capital gain and that there are no expenses directly connected with such gain. Under these facts, $20,000 of the excess net passive income is attributable to the net capital gain ($45,000 × ($40,000/$90,000)). Accordingly, the amount of gain taken into account under section 1374(b)(1) and the taxable income of Corporation M under section 1374(b)(2) shall be reduced by $20,000.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on July 2, 1985, 8:45 a.m., and published in the issue of the Federal Register for July 3, 1985, 50 F.R. 27457)

Notice of Proposed Rulemaking

Returns Required on Magnetic Media

LR-289-82

SUMMARY: This document contains proposed regulations relating to returns required to be filed on magnetic media. Changes to the applicable tax law were made by the Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462] and the Interest and Dividend Tax Compliance Act of 1983 [Pub. L. 98-67, 1983-2 C.B. 352]. The proposed regulations apply to persons required to file certain returns (other than individual, estate, and trust income tax returns), and provide guidance concerning the magnetic media filing requirements.

DATES: Written comments and requests for a public hearing must be delivered by November 18, 1985. The regulations are proposed to be effective as of the date of publication in the FEDERAL REGISTER as final regulations and would apply to returns filed after December 31, 1986.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-289-82), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: C. Scott McLeod of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T), (202)566-3288, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Procedure and Administration Regulations (26 CFR Part 301) under section 6011 of the Internal Revenue Code of 1954 relating to returns required to be filed on magnetic media. These amendments are proposed to reflect the addition to the Code of section 6011(e) by section 319 of the Tax Equity and Fiscal responsibility Act of 1982 (Pub. L. 97-248, 96 Stat. 610) [1982-2 C.B. 462, 566] and its amendment by section 109 of the Interest and Dividend Tax Compliance Act of 1983 (Pub. L. 98-67, 97 Stat. 383) [1983-2 C.B. 352, 359]. The proposed regulations provide magnetic media filing requirements for certain re-

turns (other than individual, estate, and trust income tax returns).

This document also contains proposed amendments to the table of OMB control numbers under the Paperwork Reduction Act (26 CFR part 602).

EXPLANATION OF PROVISIONS

The proposed regulations generally would require that where the use of Form 1042S (Income Subject to Withholding Under Chapter 3, Internal Revenue Code), 1098 (Mortgage Interest Statement), 1099 series (Information Return), 5498 (Individual Retirement Arrangement Information), 6248 (Annual Information Return of Windfall Profit Tax), 8027 (Employer's Annual Information Return of Tip Income and Allocated Tips), W-2 (Wage and Tax Statement), W-2G (Statement for Recipients of Certain Gambling Winnings), W-2P (Statement for Recipients of Annuities, Pensions, Retired Pay, or IRA Payments), or W-4 (Employee's Withholding Allowance Certificate) is required by the applicable regulations for the purpose of making a return, the information required by such forms shall be submitted on magnetic media. Failure to file a return on magnetic media when required to do so by the regulations would be treated as a failure to file such return and would subject the filer to the corresponding penalty. A person required to file a return on magnetic media may receive a waiver from such requirement in appropriate circumstances upon a showing of hardship.

Under the proposed regulations, filers would be required to obtain prior consent to the use of the magnetic medium on which the information is submitted. For additional information and requirements with respect to filing on magnetic media, including descriptions of types and formats of media that are acceptable, please see Rev. Proc. 85-40 page 445, this Bulletin and SSA Pub. No. 42-032 (April 1984). Although the proposed regulations would apply only to returns filed after December 31, 1986, filers are encouraged to begin use of magnetic media as soon as possible and voluntarily to begin filing on magnetic media for returns due after December 31, 1985.

The proposed regulations would provide that applications for consent to the use of a magnetic medium and requests for waiver generally must be filed at least 90 days before the filing of the first return for which consent or waiver is requested. In the case of certain returns (Forms W-2 and W-2P) filed in 1987 and 1988, however, the application for consent or request for waiver would be due no later than June 30 of the preceding year. Although the proposed regulations do not explicitly address the issue, applicable procedures would permit filing of an application for consent to the use of a particular magnetic medium together with a related request for waiver in appropriate cases.

The term "person," as used in these regulations with respect to filers of any return, includes any person required to make such return. Thus, in the case of Form W-2 or W-2P, an employer corporation is a person required to make the return even if returns are actually filed by reporting units within the corporation.

SPECIAL ANALYSIS

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required.

It is hereby certified that the regulations proposed in this document will not have a significant impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required under the Regulatory Flexibility Act (5 U.S.C. chapter 6). The certification is based on a determination that the economic impact of the proposed reporting requirements will be minimal in most cases and, in any event, is primarily attributable to requirements directly imposed by the statute. Section 6011(e)(2) provides that any taxpayer who is required to file returns under sections 6042(a), 6044(a), or 6049(a) (relating to dividends, patronage dividends, and interest) with respect to more than 50 payees for any calendar year shall file such returns on magnetic media. Section 6011(e)(1) directs the Secretary to prescribe regulations requiring magnetic media filing taking into account the ability of taxpayers to comply with the requirement at a reasonable cost.

In the case of returns to which section 6011(e)(2) applies, the magnetic media filing requirements in the proposed regulations are imposed by the statute. In the case of other returns, the proposed regulations impose no more reporting or recordkeeping requirements than are necessary to carry out the statutory directives. Moreover, under existing voluntary magnetic media reporting procedures, a significant number of those persons who would be affected by these regulations already file on magnetic media.

Under the proposed regulations, magnetic media filing is required only where the volume of filings enables magnetic media filing to be done at a reasonable cost. This is generally the case if the taxpayer's operations are computerized because filing in accordance with the proposed regulations should be less costly than paper filing. Even if the taxpayer's operations are not computerized, the incremental cost of magnetic media filing should be nominal in most cases because of the availability of computer service bureaus. The Service recognizes that filing a small number of returns on magnetic media may not be cost effective. For calendar years (or annual filing period) beginning before January 1, 1987, the proposed regulations generally permit filing on a paper form if fewer than 500 returns of information were required to be filed on that form for the preceding year (or annual period). For calendar years (or annual filing periods) beginning on or after January 1, 1987, the proposed regulations generally permit filing on a paper form if fewer than 250 returns of information were required to be filed on that form for the preceding year (or annual period). The paper form, however, must be machine-readable if applicable revenue procedures provide a machine-readable form. The proposed regulations also provide that the Commissioner may waive the magnetic media requirement upon a showing of hardship. It is anticipated that the waiver authority will be exercised so as not to unduly burden taxpayers lacking both the necessary data processing facilities and access at a reasonable cost to computer service bureaus.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for Internal Revenue Service, New Executive Office building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

DRAFTING INFORMATION

The principal author of these proposed regulations is Linda M. Kroening of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

* * * * *

Proposed amendments to the regulations

The proposed amendments to 26 CFR parts 301 and 602 are as follows:

PROCEDURE AND ADMINISTRATION REGULATIONS (26 CFR PART 301)

Paragraph 1. The authority for Part 301 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * Section 301.6011-2 also issued under 26 U.S.C. 6011(e).

Par. 2. New §301.6011-2 is added immediately after §301.6011-1 to read as follows:

§301.6011-2 Required use of magnetic media.

(a) *Meaning of terms.* The following definitions apply for purposes of this section:

(1) *Magnetic media.* The term "magnetic media" means any magnetic media permitted under applicable regulations, revenue procedures, or Social Security Administration publications. These generally include magnetic tape, disk, diskette, and cassette as well as other media specifically permitted under the applicable regulations or procedures. Use of diskette and cassette may be subject to certain limitations or special rules in the case of returns of the information required by Form W-2 or W-2P.

(2) *Machine-readable paper form.* The term "machine-readable paper form" means—

(i) Optical-scan paper form; or

(ii) Any other machine-readable paper form permitted under applicable regulations, revenue procedures, or Social Security Administration publications.

(3) *Person.* The term "person" includes the Untied States, a State, the District of Columbia, a foreign government, a political subdivision of a State or of a foreign government, or an international organization.

(b) *Returns required on magnetic media.* (1) If the use of Form 1042S, 1098, 1099 series, 5498, 6248, 8027, W-2G, W-4, or other form treated as a form specified in this paragraph (b)(1) is required by the applicable regulations or revenue procedures for the purpose of making a return, the information required by such form shall, except as otherwise provided in paragraph (c) of this section, be submitted on magnetic media. Returns on magnetic media shall be made in accordance with applicable revenue procedures. Pursuant to these procedures, the consent of the Commissioner of Internal Revenue (or other authorized officer or employee of the Internal Revenue Service) to a magnetic medium shall be obtained prior to submitting a return on such magnetic medium. An application for such consent shall be in writing and must be filed at least 90 days before the filing of the first return for which consent is requested.

(2) If the use of Form W-2, W-2P, or other form treated as a form specified in this paragraph (b)(2) is required by the regulations or revenue procedures for the purpose of making a return (not including the attachment of Form W-2 or W-2P to an Individual Income Tax Return), the information required by such form shall, except as otherwise provided in paragraph (c) of this section, be submitted on magnetic media. Returns on magnetic media shall be made in accordance with applicable Social Security Administration procedures. Thus, the consent of the Secretary of Health and Human Services (or other authorized officer or employee of the Department of Health and Human Services) to a magnetic medium shall be obtained prior to submitting a return on such magnetic medium. An application for such consent shall be in writing and must be filed—

(i) On or before June 30, 1986, in the case of returns filed in 1987;

(ii) On or before June 30, 1987, in the case of returns filed in 1988; and

(iii) At least 90 days before the filing of the first return for which consent is requested in all other cases.

(3) The Commissioner may prescribe by revenue procedure that additional forms are treated, for purposes of this section, as forms specified in paragraph (b)(1) or (b)(2) of this section.

(c) *Exceptions*—(1) *Low-volume filers*—(i) *In general.* A person required to make returns of information on a particular type of form specified in paragraph (b) of this section (other than Form 1099-DIV, 1099-PATR, 1099-INT, or 1099-OID) may make such returns on a prescribed paper form for a calendar year or other applicable annual period (whether such returns are filed during the calendar year or annual period or during the subsequent calendar year or annual period) if—

(A) In the case of a calendar year or annual period beginning before January 1, 1987—

(1) On the first day of such calendar year or annual period the person reasonably expects to file fewer than 500 returns of information on such form for the calendar year or annual period; and

(2) The person was not required to file 500 or more returns of information on such form for the preceding calen-

dar year or annual period; or

(B) In the case of a calendar year or annual period beginning on or after January 1, 1987—

(1) On the first day of such calendar year or annual period the person reasonably expects to file fewer than 250 returns of information on such form for the calendar year or annual period; and

(2) The person was not required to file 250 or more returns of information on such form for the preceding calendar year or annual period.

Alternatively, such persons may make returns on magnetic media in accordance with paragraph (b) of this section.

(ii) *Machine-readable forms.* Returns made on a paper form under this paragraph (c)(1) shall be machine-readable if applicable revenue procedures provide for a machine-readable paper form.

(iii) *Form 1099 series.* Each form within the Form 1099 series is considered a separate type of form for purposes of this paragraph (c)(1).

(2) *Special role for Form 1099-DIV, 1099-PATR, 1099-INT, 1099-OID*—(i) *50 or fewer returns.* A person required to make returns on Form 1099-DIV, 1099-PATR, 1099-INT, or 1099-OID may make such returns on a machine-readable paper form for a calendar year if—

(A) On the first day of such calendar year the person reasonably expects to file 50 or fewer returns of information on such forms for the calendar year; and

(B) The person was not required to file more than 50 returns of information on such forms for the preceding calendar year.

Alternatively, such persons may make returns on magnetic media in accordance with paragraph (b) of this section.

(ii) *Aggregation of returns.* For purposes of determining the number of returns that a person was required to file or reasonably expects to file on Form 1099-DIV, 1099-PATR, 1099-INT, or 1099-OID, all such returns shall be aggregated. For example, if a person filed 30 Form 1099-INT's and 30 Form 1099-DIV's for a calendar year, or reasonably expects to do so for the succeeding calendar year, all returns made by such person on Form 1099-DIV, 1099-PATR, 1099-INT and 1099-OID for the succeeding calendar year shall be on magnetic media.

(3) *Provided by regulations*—(i) *In general.* This section does not apply to a return if the regulations relating to such return require reporting on magnetic media.

(ii) *Example.* The following example illustrates the application of the rule in paragraph (c)(3)(i) of this section:

Example. Section 1.6045-1(d), relating to returns of information of brokers and barter exchanges, requires the use of magnetic media as the method of reporting. Thus, this section does not apply to returns of information under section 6045.

(4) *Waiver.* The Commissioner may waive the requirements of this section if hardship is shown in an application filed in accordance with this paragraph (c)(4). Such waiver shall specify the type of form and period to which it applies and shall be subject to such terms and conditions regarding the method of reporting as may be prescribed by the Commissioner. In determining whether hardship has been shown, the principal factor to be taken into account will be the amount, if any, by which the cost of filing returns in accordance with this section exceeds the cost of filing the returns on other media. A request for waiver shall be in writing and must be filed—

(i) On or before June 30, 1986, in the case of returns on Form W-2 or W-2P filed in 1987;

(ii) On or before June 30, 1987, in the case of returns on From W-2 or W-2P filed in 1988; and

(iii) At least 90 days before the filing of the first return for which a waiver is requested in all other cases.

(d) *Paper form returns.* Returns submitted on paper forms (whether or not machine-readable) permitted under paragraph (c) of this section shall be made in accordance with applicable revenue or Social Security Administration procedures.

(e) *Applicability of current procedures.* Until procedures are prescribed which further implement that the mandatory filing on magnetic media provided by this section, a return to which this section applies shall be made in the manner and shall be subject to the requirements and conditions (including the requirement of applying for consent to the magnetic medium) prescribed in the regulations, revenue procedures and Social Security Administration publications relating to the filing of such return on magnetic media. In addition, consent to the use of a magnetic medium obtained in accordance with such regulations, revenue procedures and Social Security Administration publications (regardless of when obtained) will be considered consent to the use of such medium for purposes of paragraph (b) of this section.

(f) *Failure to file.* If a person fails to file a return on magnetic media when required to do so by section 6011(e) and this section, such person is deemed to have failed to file the return and is subject ot the corresponding penalties for failure to file such return.

(g) *Effective date.* this section applies to returns filed after December 31, 1986.

OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT
(26 CFR Part 602)

Par. 3. the authority for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. Section 602.101(c) is amended by inserting in the appropriate place in the table "§301.6011-2 . . . | |".

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on September 13, 1985 10:53 a.m., and published in the issue of the Federal Register for September 18, 1985 37871)

Notice of Proposed Rulemaking

Administrative Summonses

LR-10-83

SUMMARY: This document contains proposed regulations relating to administrative summonses. Changes to the applicable tax law were made by the Tax Equity and Fiscal Responsiblity Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462]. The regulations provide the public with the guidance needed to comply with that Act and affect persons who receive summonses, third party recordkeepers who receive summonses, and persons with respect to whose tax

liability a summons is issued.

DATES: Written comments and requests for a public hearing must be delivered or mailed by August 12, 1985. The regulations pertaining to section 7602 of the Code are proposed to be effective after September 3, 1982. The regulations pertaining to section 7609 of the Code are proposed to be effective for summonses served after December 31, 1982.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T [LR-10-83], 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Bruce H. Jurist of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, (Attention: CC:LR:T) 202-566-3238, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

These proposed regulations would amend the Regulations on Procedure and Administration (26 CFR Part 301) under sections 7602 and 7609 of the Internal Revenue Code of 1954. Changes to the applicable tax law were made by sections 331, 332, and 333 of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) (96 Stat. 620) [Pub. L. 97-248, 1982-2 C.B. 462, 571,572]. The proposed regulations are to be issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

ADMINISTRATIVE SUMMONSES

Under prior law the Secretary could issue summonses allowing for the examination of books, records, or witnesses for the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax, or collecting such liability. The Secretary could not issue an administrative summons once the Internal Revenue Service had referred the case to the Justice Department for criminal prosecution, or had made an institutional commitment to refer the case to the Justice Department for criminal prosecution. This judicially conceived limitation, articulated in the case of *United States* v. *Lasalle*, 437 U.S. 298 (1978), spawned protracted litigation.

In order to simplify the determination of when the power to issue an administrative summons exists and when it does not exist in cases with a criminal aspect, Congress promulgated section 333 of TEFRA. The Act expands the Secretary's authority by including the right to issue a summons for the purpose of inquiring into any offense connected with the administration or enforcement of the internal revenue laws. Concurrently, the Act establishes a mechanical test for determining when the Secretary no longer has the power to issue a summons. The former test, based on institutional commitment, is abolished. Under the new test, the Secretary ceases to have authority to issue a summons once a case is referred to the Department of Justice.

These proposed regulations provide guidelines for determining when a referral to the Department of Justice is in effect.

SPECIAL PROCEDURE FOR THIRD-PARTY SUMMONSES

Generally, when a summons is served upon a third-party recordkeeper (recordkeeper) to examine records, section 7609(a) requires that notice be given of the service of the summons to the taxpayer and any other person who is identified in the description of the records contained in the body of the summons (the notified person). Under prior law, the notified person could prevent the recordkeeper from complying with a third-party summons by notifying the recordkeeper in writing not to comply with the summons and mailing a copy of this notice to the Secretary by registered or certified mail. The burden was on the Service to commence a proceeding to enforce the summons. These provisions were used frequently by taxpayers, solely to delay enforcement of summonses without regard to the merit of any objection they might have.

Section 331 of TEFRA shifts the burden of commencing litigation with respect to the validity of a third-party summons to the notified person. The notified person's right to stay compliance is replaced with the right to institute a proceeding to quash.

In addition, under prior law, there was no requirement that third-party recordkeepers immediately proceed to assemble summoned records. Section 332 of TEFRA requires recordkeepers to assemble the summoned records within the time allotted on the face of the summons.

These regulations contain interpretative guidelines as to how a notified person may institute a proceeding to quash. They also contain guidelines setting forth the duty of recordkeepers to assemble records, and procedures by which recordkeepers may be relieved of liability for disclosing records under certain circumstances.

COMMENTS AND REQUEST FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that these proposed regulations are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact analysis is not required. Although this document is a notice of proposed rulemaking that solicits public comments the Internal Revenue Service has concluded that these regulations are interpretive and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Therefore, a Regulatory Flexibility Analysis is not required.

DRAFTING INFORMATION

The principal author of these proposed regulations is Bruce H. Jurist of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, per-

sonnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Proposed amendments to the regulations

The proposed amendments to 26 CFR Part 301 are as follows:

Paragraph 1. Section 301.7602-1 is amended by revising paragraphs (a) and (b) and adding new paragraphs (c) and (d). The amended section reads as follows:

§301.7602-1 Examination of books and witnesses.

(a) *In general.* For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax (including any interest, additional amount, addition to the tax, or civil penalty) or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, collecting any such liability, or inquiring into any offense connected with the administration or enforcement of the internal revenue laws, any authorized officer or employee of the Internal Revenue Service may examine any books, papers, records or other data which may be relevant or material to such inquiry; and take such testimony of the person concerned, under oath, as may be relevant to such inquiry.

(b) *Summons.* For the purposes described in paragraph (a) of this section the Commissioner is authorized to summon the person liable for tax or required to perform the act, or any officer or employee of such person or any person having possession, custody, or care of books of accounts containing entries relating to the business of the person liable for tax or required to perform the act, or any other person deemed proper, to appear before a designated officer or employee of the Internal Revenue Service at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry. This summons power may be utilized in an investigation of either civil or criminal tax-related liability. The Commissioner may designate any employee of the Internal Revenue Service as the individual before whom a person summoned pursuant to section 6420(e)(2), 6421(f)(2), 6424(d)(2), 6427(e)(2), or 7602 shall appear. Any such employee, when so designated in a summons, is authorized to take testimony under oath of the person summoned and to receive and examine books, papers, records, or other data produced in compliance with the summons.

(c) *Proscription on issuing of administrative summons when a Justice Department referral is in effect*—(1) *In general.* The Commissioner may neither issue a summons under this title nor initiate a proceeding to enforce a previously issued summons by way of section 7604 with respect to any person whose tax liability is in issue, if a Justice Department referral is in effect with respect to that person for that liability.

(2) *Justice Department referral in effect.* A Justice Department referral is in effect with respect to any person when:

(i) The Secretary recommends, within the meaning of this paragraph, that the Attorney General either commence a grand jury investigation of or criminal prosecution of such person for any alleged offense connected with the administration or enforcement of the internal revenue laws, or

(ii) The Attorney General (or Deputy Attorney General or Assistant Attorney General) under section 6103(h)(3)(B) requests in wrting that the Secretary disclose a return of, or return information relating to, such person. The request must set forth that the need for disclosure is for tax administration purposes.

The referral is effective at the time the document recommending criminal prosecution or grand jury investigation is signed by the Secretary or upon the Secretary's receipt of the section 6103(h)(3)(B) request.

(3) *Cessation of Justice Department referral.* A Justice Departent referral ceases to be in effect with respect to a person:

(i) When the Secretary receives written notification from the Attorney General that the Justice Department:

(A) Will not prosecute that person for any offense connected with the administration or enforcement of the internal revenue laws that gave rise to the referral under paragraph (2)(i) of this section, or

(B) Will not authorize a grand jury investigation of that person with respect to such offense, or

(C) Will discontinue any grand jury investigation of that person with respect to such offense;

(ii) When a final disposition with respect to a criminal proceeding brought against that person has been made; or

(iii) When the Secretary receives written notification from the Attorney General Deputy Attorney General, or an Assistant Attorney General, that the Justice Department will not prosecute such person for any offense connected with the administration or enforcement of the internal revenue laws, based upon a previous request for disclosure under section 6103(h)(3)(B).

(4) *Taxable years and taxes imposed by separate chapters of the Code treated separately*—(i) *In general.* For purposes of this section, each taxable period (or, if there is no taxable period, each taxable event) and each tax imposed by a separate chapter of the Code is treated separately.

(ii) Examples. The following examples illstrate the application of this paragraph (c)(4):

Example (1). A Justice Department referral is in effect for D's criminal evasion of income tax for the taxable year 1979. The Commissioner may issue a summons respecting D's 1980 criminal and/or civil tax liability. The Commissioner may not issue a summons respecting D's 1979 income tax liability.

Example (2). A referral has been made to the Department of Justice for the criminal prosecution of F with regard to F's income tax liability for the taxable year 1978. The Commissioner may issue a summons respecting F's gift tax liability for the taxable year 1978.

Example (3). A referral has been made to the Department of Justice for a grand jury investigation respecting G's 1980 income tax liability. The Commissioner may issue a summons related to an investigation of G's liability for Federal Insurance Contribution Act (FICA) taxes for the taxable year 1980.

Example (4). A referral has been made to the Department of Justice respecting J's criminal evasion of windfall profit tax for all quarters of the calendar year 1982. The Commissioner may issue a summons respecting J's liability for highway motor vehicle use tax covering the same periods.

(d) *Effective date.* This section is effective after September 3, 1982. For rules effective on or before September

3, 1982, see 26 CFR 301.7602-1 (revised as of April 1, 1984).

Par. 2. Section 301.7609-1 is amended by designating the original text as paragraph (a), revising redesignated paragraph (a), and adding a new paragraph (b). The amended section reads as follows:

§391.7609-1 Special procedures for third-party summonses.

(a) *In general.* Section 7609 requires the Internal Revenue Service to follow special procedures when summoning the records of persons defined by section 7609(a)(3) as "third-party recordkeepers." Under these special procedures, the person about whom information is being gathered must be notified in advance in many cases. If the person about whom information is being gathered has received a notice that person has the right to institute, until and including the 20th day following the day such notice was served on or mailed to such notified person, a proceeding to quash the summons. During the time the validity of the summons is being litigated, the statutes of limitations are suspended under section 7609(e). Section 7609 does not restrict the authority under section 7602 (or under any other provision of law) to examine records and witnesses without serving a summons and without giving notice of an examination. Sections 301.7609-1 through 301.7609-5 relate to section 7609; §301.7609-2, discusses matters under sections 7609(a)(32) and 7609(i) relating to third-party recordkeepers; §301.7609-3 discusses matters under section 7609(b), relating to intervention rights; and the institution of a proceeding to quash; §301.7609-4 discusses matters under section 7609(c), relating to summonses excepted from the section 7609 procedures; and §301.7609-5 discusses matters under section 7609(e), relating to the suspension of the statute of limitations.

(b) *Effective dates.* This section applies to summonses served after December 31, 1982. For the rules applicable to summonses issued on or after March 1, 1977 and served before January 1, 1983, see 26 CFR 301.7609-1 (revised as of April 1, 1984).

Par. 3. Section 301.7609-2 is amended by adding new paragraphs (c) and (d). The amended section reads as follows:

§301.7609-2 Third-party recordkeepers.

* * * * *

(c) *Duty of third-party recordkeeper*—(1) *In general.* Upon receipt of a summons, the third-party recordkeeper ("recordkeeper") must begin to assemble the summoned records. The recordkeeper must be prepared to produce the summoned records on the date which the summons states the records are to be examined regardless of the institution or anticipated institution of a proceeding to quash or the recordkeeper's intervention (as allowed under section 7609(b)(2)(C)) into a proceeding to quash.

(2) *Disclosing recordkeepers not liable*—(i) *In general.* A recordkeeper, or an agent or employee thereof, who makes a disclosure of records as required by this section, in good faith reliance on the certificate of the Secretary (as defined in paragraph (c)(2)(ii) of this section) or an order of a court requiring production of records, will not be liable for such disclosure to any customer, or to any party with respect to whose tax liability the summons was issued, or to any other person.

(ii) *Certificate of the Secretary.* The Secretary may issue to the recordkeeper a certificate stating both:

(A) that the 20 day period, within which a notified person may institute a proceeding to quash the summons, has expired; and

(B) that no proceeding has been properly instituted within that period.

The Secretary may also issue a certificate to the recordkeeper if the taxpayer, with respect to whose tax liability the summons was issued, expressly consents to the examination of the records summoned.

(3) *Reimbursement of costs.* Recordkeepers may be entitled to reimbursement of their costs of assembling and preparing to produce summoned records, to the extent allowed by section 7610, even if the summons ultimately is not enforced.

(d) *Effective dates.* This section, with the exception of paragraph (c), applies generally to all summonses issued on or after March 1, 1977. Paragraph (c) applies only to summonses served after December 31, 1982.

Par. 4. Section 301.7609-3 is amended by revising paragraphs (a), (b), (c), and by adding new paragraph (d). The amended section reads as follows:

§301.7609-3 Right to Intervene; right to institute a proceeding to quash.

(a) *Notified person.* Under section 7609(a), the Internal Revenue Service must give a notice of summons to any person, other than the person summoned, who is identified in the description of the books and records contained in the summons in order that such person may contest the right of the Service to examine the summoned records by instituting a proceeding to quash the summons. Thus, if the Service issues a summons to a bank requesting checking account records of more than one person all of whom are identified in the description of the records contained in the summons, then all such persons are notified persons entitled to notice under section 7609(a). Therefore, if the Service requests the records of a joint bank account of A and B both of whom are named in the summons, then both A and B are notified persons entitled to notice under section 7609(a).

(b) *Right to institute a proceeding to quash*—(1) *In general.* Section 7609(b) grants a notified person the right to institute a proceeding to quash the summons in the United States district court for the district within which the person summoned resides or is found. Jurisdiction of the court is based on section 7609 (h). The act of filing a petition in district court does not in and of itself institute a proceeding to quash under section 7609(b)(2). Rather, the filing of the petition must be coupled with notice as required by section 7609(b)(2)(B).

(2) *Elements of institution of a proceeding to quash.* In order to institute a proceeding to quash a summons the notified person (or the notified person's agent, nominee, of other person acting under the direction or control of the notified person) must, not later than the 20th day following the day the notice of the summons was served on or mailed to such notified person:

(i) file a petition to quash in a district court having jurisdiction,

(ii) notify the Service by sending a copy of that petition by registered or certified mail to the Service employee and office designated to receive the

copy in the notice of summons that was given to the notified person, and

(iii) notify the recordkeeper by sending to that recordkeeper by registered or certified mail a copy of the petition.

Failure to give timely notice to either the summoned party or the Service in the manner described in this paragraph mreans that the notified person has failed to institute a proceeding to quash and the district court has no jurisdiction to hear the proceeding. Thus, for example, if the notified person mails a copy of the petition to the summoned person but not to the designated Service employee and office, the notified person has failed to institute a proceeding to quash. Similarly, if the notified person mails a copy of such petition to the summoned person but, instead of sending a copy of the notice by registered or certified mail to the designated employee and office, the notified person gives the designated employee and office the petition by some other means, the notified person has failed to institute a proceeding to quash.

(3) *Failure to institute a proceeding to quash.* If the notified person fails to institute a proceeding to quash within 20 days following the day the notice of the summons was served on or mailed to such notified person, the Service may examine the summoned records following the 23rd day after notice of the summons was served on or mailed to the notified person (see section 7609(d)(1)).

(c) *Presumption no notice has been mailed.* Section 7609(b)(2)(B) permits a notified person to institute a proceeeding to quash by filing a petition in district court and notifying both the Service and the summoned person. Unless the notified person has notified both the Service and the summoned person in the appropriate manner, the notified person has failed to institute a proceeding to quash. If the copy of the petition has not been delivered to the summoned person or the person and office designated to receive the notice on behalf of the Service within 3 days from the close of the 20-day period allowed to institute a proceeding to quash, it is presumed that the notification has not been timely mailed.

(d) *Effective date.* This section applies to summonses served after December 31, 1982. For the rules applicable to summonses issued on or after March 1, 1977 and served before January 1, 1983, see 26 CFR 301.7609-3 (revised as of April 1, 1984).

Par. 5. Section 301.7609-4 is amended by adding new paragraph (c). The amended section reads as follows:

§301.7609-4 Summons excepted from section 7609 procedures.

* * * * *

(c) *Effective date.* This section applies to all summonses issued after February 28, 1977.

Par. 6. Section 301.7609-5 is amended by revising paragraphs (b) and (c) and by adding new paragraph 9d). The amended section reads as follows:

§301.7609-5 Suspension of statutes of limitation.

* * * * *

(b) *Period during which a proceeding, etc., is pending.* Under section 7609(e), the statute of limitations may be suspended for the period during which a proceeding, and appeals therein, with respect to the enforcement of such summons is pending. This period begins on the date the petition to quash the summons is filed in District Court. The period continues until all appeals are disposed of, or until the expiration of the period in which an appeal may be taken or a request for a rehearing may be made. Full compliance, partial compliance, and noncompliance have no effect on the suspension provisions. Of course, if the notified person takes no action provided in subsection (b) of section 7609, no suspension of the statutes of limitations takes place. The periods of limitations which are suspended under section 7609(e) are those which apply to the taxable periods to which the summons relates.

(c) *Taking of action as provided in section 7609(b).* Section 7609(b) allows intervention by a notified person as a matter of right upon compliance with the Federal Rules of Civil Procedure. The phrase "takes any action as provided in subsection (b)," found in section 7609(e), includes any intervention, whether or not section 7609(b) is specifically mentioned in the order of the court allowing intervention. The phrase also includes the fulfilling of only part of the requirements of section 7609(b)(2), relating to the right of a person to institute a proceeding to quash. Thus, for instance, if a notified person notifies a person who has been summoned by sending a copy of the petition by registered or certified mail but does not mail a copy of that notice to the appropriate person and office under section 7609(b)(2)(B), the notified person has taken an action under section 7609(e).

(d) *Effective dates.* This section applies to summonses served after December 31, 1982. For the rules applicable to summonses issued on or after March 1, 1977 and before January 1, 1983, see 26 CFR 301.7609-5 (revised as of April 1, 1984).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on June 11, 1985, 8:45 a.m., and published in the issue of the Federal Register for June 12, 1985, 50 F.R. 24655)

Notice of Proposed Rulemaking

Excise Taxes on Gasohol and Other Alcohol Mixture Fuels, Tires, Tread Rubber, and Inner Tubes

LR–119–83

SUMMARY: This document contains proposed regulations relating to the excise tax on gasohol and other alcohol mixture fuels. This document also contains proposed regulations relating to the rate of excise tax on tires, tread rubber, and inner tubes. Changes to the applicable regulations relating to gasohol and other alcohol mixture fuels and tires are necessary due to amendments made by the Highway Revenue Act of 1982 [Pub. L. 97-424, 1983-1 C.B. 405] and the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. These regulations would provide necessary guidance to Internal Revenue Service personnel who administer the Code and members of the public who are subject to these laws.

DATES: Written comments and requests for a public hearing must be delivered or mailed by October 21, 1985. The regulations relating to alcohol fuels are proposed to be effective generally for sales or uses made on and after April 1, 1983. The regulations relating to tires are proposed to be effective for sales or uses on and after January 1, 1984.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-119-83), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Margaret M. O'Connor of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Excise Tax Regulations (26 CFR Part 48) under sections 4041, 4071, 4081, 6420 and 6427 of the Internal Revenue Code of 1954 (Code) and are issued under the authority contained in section 511(d)(1)(A) and 511(d)(2) of the Highway Revenue Act of 1982 (1982 Act) (Pub. L. 97-424, 96 Stat. 2171) [1983-1 C.B. 405, 406-07] and sections 732(a)(1), 912(a) and 912(b) of the Tax Reform Act of 1984 (1984 Act) (Pub. L. 98-369, 98-369, 98 Stat. 976 and 1007) [1984-3 C.B. (Vol. 1) 1, 484, 515]. The amendments are proposed to conform the regulations to sections 511(b), (d), (e), (f) and 514 of the 1982 Act and sections 732(a), 912(a), 912(b), 912(d), 912(f) and 913 of the 1984 Act.

TAXATION OF QUALIFYING ALCOHOL MIXTURE FUELS

In General

Prior to the passage of the 1982 Act, certain qualifying alcohol mixture fuels under section 4041(k) and section 4081(c) were entirely exempt from the tax imposed by sections 4041(a), relating to special fuels, and 4081(a), relating to gasoline. Sales of gasoline in order to produce a qualifying alcohol mixture fuels were also exempt from tax under section 4081(c). To qualify for the exemptions under either section 4041(k) or 4081(c), the alcohol mixture fuels was required to contain at least 10% alcohol by volume.

Under the 1982 Act, the tax on diesel fuel, special fuel and gasoline was increased from 4 cents per gallon to 9 cents per gallon. In addition, the 1982 Act eliminated the complete exemption for sales and uses of qualifying alcohol mixture fuels so that gasohol and alcohol mixture fuels sold or used after March 31, 1983, are taxed at a reduced rate. The 1984 Act, effective for sales or uses after December 31, 1984, amended the reduced rate of tax on gasohol and alcohol mixture fuels produced from special fuels to 3 cents per gallon and changed the rate of tax on alcohol mixture fuels produced from diesel fuels to 9 cents per gallon. These amendments increased the differential in tax rate between the qualifying alcohol mixture fuels and the fuels not containing the required mixture of alcohol to six cents per gallon. The proposed regulations clarify that the tax on qualifying alcohol mixture fuels is assessed upon the total volume of the mixture and not merely upon the nonalcohol content of the mixture.

Under technical amendments made by the 1984 Act (effective as if included in the 1982 Act), section 4081(c) also provides that gasoline sold for blending into gasohol is subject to a tax of 4 4/9 cents per gallon of gasoline. By applying this rate of tax, the total tax upon the sale of gasoline to be blended into gasohol is equivalent to the total tax of 4 cents per gallon which otherwise would be imposed upon the sale of the gasohol ultimately produced, assuming the gasohol contains 10% alcohol by volume. In this way, if tax has been paid upon the gasoline sold for blending into gasohol, no further tax will be imposed upon the subsequent sale or use of the gasohol produced. The 1984 Act decreased the tax upon gasoline sold for blending into gasohol to 3⅓ cents per gallon for sales after December 31, 1984, to conform this tax rate with the reduction in the rate of tax on gasohol.

Under the proposed regulations a producer of gasohol qualifies as a producer as defined in section 4082 of the Code and may register as such. If the producer is registered, the sale of gasoline to such producer of gasohol may be tax free under the rules of section 4083. If the sale of gasoline is tax free due to the application of section 4083, the tax will be imposed at the applicable rate upon the gasohol produced.

The proposed regulations specify that in order to determine whether the alcohol mixture contains at least 10% alcohol, the volume of each component in the fuel will be adjusted to its volume at a standard temperature of 60° Fahrenheit. This uniform temperature is necessary in order to take into account changes in volume and density of motor fuels and alcohol which occur with changes in temperatures. Such changes occur at different rates and at different temperatures for different fuels. Consequently, if temperature is not standardized, variations can occur in the percentage physical makeup of alcohol mixtures with identical mixture ratios, due to differences in the temperatures of the components.

Separation of or Failure to Blend Qualifying Alcohol Mixture Fuel

The 1982 Act and the 1984 Act also amended provisions regarding the tax consequences of separating the nonalcohol components of a qualifying alcohol mixture fuel or failing to blend gasoline into gasohol. Under prior law if the sale of a qualifying alcohol mixture was tax free under section 4041 separation of the liquid fuel would be treated as a sale subject to the 4 cent per gallon tax imposed on fuels not containing the required alcohol mixture. In addition if the sale of a qualifying mixture of alcohol and gasoline or the sale of gasoline for use in producing a qualifying mixture had been tax free under section 4081(c), the person who separated the gasoline from the gasohol or failed to blend the gasoline into gasohol would be considered the producer of such gasoline and would be subject to a tax of 4 cents per gallon upon its sale. In order to conform these provisions with the changes in the taxation of alcohol mixture fuels the 1982 Act provides that the separation of the special fuel or diesel fuel from a qualifying mixture is treated as a sale subject to the applicable tax imposed upon the type of fuel which has been separated, reduced by any tax previously paid on the fuel. Thus, if special fuel has been separated from an alcohol mixture, it is subject to a 9 cents per gallon tax reduced by the tax paid on the mixture. If diesel fuel has been separated from an alcohol mixture before August 1, 1984, it is subject to a 9 cents per gallon tax reduced by the tax previously paid. If diesel fuel has been separated after July 31, 1984, it is subject to a 15 cents per gallon tax, re-

duced by the tax previously paid.

The proposed regulations also provide that a person who separates or fails to blend gasoline into a qualifying mixture will be considered a producer subject to, upon the sale of the gasoline, a tax of 9 cents per gallon if the mixture or gasoline had been purchased tax-free, 4 5/9 cents per gallon if the mixture or gasoline had been purchased at the reduced rate of tax in effect before January 1, 1985, or 5⅔ cents per gallon if the mixture had been purchased at the reduced rate of tax in effect after December 31, 1984.

Credits and Refunds

The 1982 Act and the 1984 Act also revised section 6427(f), which relates to refunds or credits available to gasohol prroducers where the gasoline used to produce gasohol had been previously taxed at the higher rates imposed by section 4081 (a). Under prior law, the gasohol producer was entitled to a full refund or credit. Under both the 1982 Act and the 1984 Act and the proposed regulations, the refund or credit is equal to the excess of the tax paid upon the sale of gasoline over the tax which would have been paid on gasoline sold in order to produce gasohol. Thus, under the 1982 Act, if a blender purchases tax-paid gasoline subject to tax at a rate of 9 cents per gallon and uses it to blend qualifying gasohol; then the blender will be entitled to a credit of 4 5/9 cents per gallon of gasoline so used upon the sale of the gasohol or its use in the trade or business of the blender before January 1, 1985. Under the 1984 Act, if the mixture produced from gasoline taxed at a rate of 9 cents per gallon is sold or used in the blender's trade or business after December 31, 1984, the blender is entitled to a credit of 5⅔ cents per gallon of gasoline so used.

Exemptions From Fuel Tax

The 1982 Act also extended the refund provisions previously available to the ultimate purchaser for fuel used by aerial applicators for farming purposes under sections 6420 and 6427 to other applicators as well. Thus, under the proposed regulations, the ultimate purchaser of fuel who uses such fuel in the aerial application or other application of fertilizers, herbicides, pesticides, and other farm processes is entitled to a refund of the tax paid on the motor fuels.

A new exemption from all the fuel taxes was also created by the 1982 Act under section 4041(b)(2) for sales and uses of fuels consisting of at least 85% methanol, ethanol or other alcohols derived from sources other than petroleum or natural gas. The exemption is effective for sales and uses after March 31, 1984. The proposed regulations explain this new exemption and provide standards for qualification for this exemption.

A partial exemption from fuel tax was added by section 913(a) of the 1984 Act. Under section 4041(m) sales and uses of fuels consisting of at least 85% methanol, ethanol or other alcohols produced from natural gas will be taxed at a reduced rate of 4 ½ cents per gallon. This partial exemption is effective for sales and uses after July 31, 1984. Because these fuels are produced from natural gas, they do not qualify for the full exemption under section 4041(b)(2). Prior to the amendment made by the 1984 Act, such fuels were taxed at the rates imposed by section 4041(a) relating to diesel and special motor fuels or 4081(a) relating to gasoline.

MANUFACTURER'S TAX ON TIRES

These proposed regulations update the tax rate tables applicable to tires sold after December 31, 1983, and conform the regulations to section 514(a) of the 1982 Act which repealed the tax on nonhighway tires, laminated tires, inner tubes and tread rubber, effective January 1, 1984. The proposed regulations also provide that the determination of the weight of tires for purposes of the excise tax may be based upon averages computed by any method approved by the Commissioner rather than solely by averages published by the tire industry. See existing §48.4071-2(b).

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although this document is a notice of proposed rulemaking which solicits public comments, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably eight copies) to the Commission of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20303. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

DRAFTING INFORMATION

The principal author of these proposed regulations is Margaret M. O'Connor of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

* * * * *

Proposed amendments to the regulations.

The proposed amendments to 26 CFR Part 48 are as follows:

Paragraph 1. The authority for Part 48 continues to read in part:

Authority: 26 U.S.C. 7805.* * * Section 48.4041-18 also issued under 26 U.S.C. 4041(k)(1); §48.4041-2 also issued under 26 U.S.C. 4081(c)(1).

* * *

Par. 2. Section 48.4041-14 is redesignated as §48.4041-18 and revised to read as set forth below.

§48.4041-18 Fuels containing alcohol.

(a) *In general*—(1) *Sale or use after December 31, 1984 and before January 1, 1993.* Under section 4041(k) the rate of tax applicable to the sale or use after December 31, 1984 and before January 1, 1993, of any liquid fuel described in section 4041(a)91) or (2) which consists of at least 10% alcohol by volume is:

(i) 9 cents for each gallon of alcohol mixture sold or used in the case of mixtures described in section 4041(a)(1); or

(ii) 3 cents for each gallon of alcohol mixture sold or used in the case of mixtures described in section 4041(a)(2).

The amount of tax is based upon the total volume of fuel and not merely upon the volume of the nonalcohol components of such fuel. However see section 4041(b)(2) and §48.4041-19 for rules relating to the complete exemption from taxes imposed by section 4041(a) where at least 85% of the fuel consists of alcohol produced from certain sources.

(2) *Sale or use after March 31, 1983, and before January 1, 1984.* For rules relating to the rate of tax imposed on the sale or use after March 31, 1983, and before January 1, 1984 of any liquid fuel described in section 4041(a)(1) or (2) which consists of at least 10% alcohol by volume, see section 4041(k) prior to the enactment of the Tax Reform Act of 1984 (Pub. L. 98-369, 98 Stat. 1007).

(3) *Sale or use before April 1, 1983.* No tax is imposed upon the sale or use of any liquid fuel described in section 4041(a)(1) or (a)(2) which consists of at least 10% alcohol if the sale or use occurs after December 31, 1978 and before April 1, 1983.

(b) *Alcohol mixture fuels qualifying for special tax treatment.* In order to qualify for the reduced rates of tax described in paragraphs (a)(1) and (a)(2) of this section or the exemption from tax described in paragraph (a)(3) of this section, at least 10% of an alcohol mixture fuel must consist of alcohol as defined in section 4081(c) and §48.4081-2(a)(3) of the regulations. To determine the percentage of alcohol present in a fuel, the actual gallonage of each chemical component will be adjusted to equivalent gallonage at 60° Fahrenheit.

(c) *Later separation.* If a person separates out the alcohol from a mixture which has been taxed under the rates of section 4041(k), such separation will be treated as a sale of the liquid on the date separated and is subject to tax at the rates set forth under section 4041(a)(1) or (2). The tax liability incurred upon the separation is reduced by the amount of any tax previously imposed under section 4041. Thus, if Y buys 1000 gallons of alcohol mixture fuel taxed at the rate of 3 cents per gallon under section 4041(k) and later separates the fuel into 900 gallons of special motor fuel and 100 gallons of alcohol, the separation is treated as a sale of 900 gallons of special motor fuel, taxed at the rate of 9 cents per gallon under section 4041(a), and a sale of 100 gallons of alcohol, exempt from tax under section 4041(b)(2). The tax of $81 on the deemed sale of special motor fuel is reduced by the tax of $30 previously paid on the sale of the alcohol mixture fuel.

(d) *Exemption from tax for alcohol mixture fuels sold or used in an aircraft in noncommercial aviation*—(1) *In general.* No tax is imposed upon the sale or use of any liquid fuel described in section 4041(a)(1) or (a)(2) which consists of at least 10% alcohol if such fuel is sold to or used by an owner, lessee or other operator of an aircraft as fuel in such aircraft in noncommercial aviation. See section 4041(c)(4) and the regulations thereunder for the definition of noncommercial aviation.

(2) *Failure to use alcohol mixture fuel in an aircraft in noncommercial aviation.* If fuel which is exempt from tax under paragraph (d)(1) of this section is not used as fuel in an aircraft in noncommercial aviation, any other use or sale of such fuel will be considered the use or sale of an alcohol mixture fuel subject to tax according to the rules of this section.

(e) *Refunds relating to diesel, special motor and noncommercial aviation fuels.* See section 6427 for rules which relate to the allowance of a refund or credit to a person who uses tax-paid diesel, special motor or noncommercial aviation fuels to produce an alcohol mixture fuel.

(f) *Alcohol mixture fuel within the tank of a vehicle*—(10) *Mixtures within the tank of a vehicle before April 1, 1983.* If an alcohol mixture fuel is put into the tank of a vehicle prior to April 1, 1983, the fuel is considered used prior to that date. Thus, such fuel will not be subject to the tax described in paragraph (a)(2) of this section and will be exempt from tax according to the provision of paragraph (a)(3) of this section.

(2) *Mixture within the tank of a vehicle before January 1, 1985.* If an alcohol mixture is put into the tank of a vehicle prior to January 1, 1985, the fuel is considered used prior to that date. Thus, such fuel is subject to the tax described in paragraph (a)(2) of this section.

Par. 3. A new §48.4041-19 is added to read as set forth below.

§48.4041-19 Exemption for qualified methanol and ethanol fuel.

(a) *In general.* Under section 4041(b)(2), the tax imposed upon the sale or use of motor fuels under section 4041(a) does not apply to the sale or use of qualified methanol or ethanol fuel.

(b) *Qualified methanol or ethanol fuel defined.* For purposes of section 4041(b)(2) and this section, qualified methanol or ethanol fuel is liquid motor fuel, 85% of the volume of which consists of alcohol, as defined in section 4081(c) and §48.4081-2(a)(3) of the regulations as modified by the following sentence. For purposes of section 4041(b)(2) and this section, the alcohol contained in a qualified methanol or ethanol fuel may be produced from coal. In determining whether the 85 percent alcohol requirement has been met with respect to a mixture, the actual gallonage of each chemical component will be adjusted to equivalent gallonage at 60° Fahrenheit.

(c) *Refunds relating to fuels used to produce qualified fuels.* See section 6427 for rules which relate to the allowance of a refund or credit to a person who uses tax-paid diesel, special

motor or noncommercial aviation fuels to produce a qualified methanol or ethanol fuel and section 6416 for rules which relate to the allowance of a refund or credit to a person who uses tax-paid gasoline to produce a qualified methanol or ethanol fuel.

(d) *Later blending.* If a qualified methanol or ethanol fuel is blended with other motor fuel in a mixture less than 85 percent of which consists of alcohol, the subsequent sale or use of such alcohol mixture fuel is taxable under the provisions of section 4041 or section 4081 subject to the requirements, limitations and exemptions of those sections. Thus, if the alcohol mixture fuel is at least 10% alcohol by volume, sale or use of the fuel is taxed at the rates provided in section 4041(k) or section 4081(c), but if the fuel is less than 10% alcohol, sale or use of the fuel is taxed at the rates provided in section 4041(a) or section 4081(a).

(e) *Effective date.* Section 4041(b)(2) applies to sales or uses after March 31, 1983, and before October 1, 1988.

Par. 4. A new §48.4041-20 is added to read as set forth below.

§48.4041-20 Partially exempt methanol and ethanol fuel.

(a) *In general.* Under section 4041(m), the sale or use of partially exempt methanol or ethanol fuel is taxed at the rate of 4 ½ cents per gallon of fuel sold or used. The amount of tax is based upon the total volume of fuel and not merely upon the nonalcohol portion of the fuel.

(b) *Partially exempt methanol or ethanol fuel defined.* For purposes of section 4041(m) and this section, partially exempt methanol or ethanol fuel is liquid motor fuel, 85% of which by volume consists of alcohol, as defined in section 4081 and §48.4081-2(a)(3) of the regulations, as modified by the following sentence. For purposes of section 4041(m) and this section, the alcohol contained in partially exempt methanol or ethanol fuel must be produced from natural gas. In determining whether the 85 percent alcohol requirement has been met with respect to a mixture, the actual gallonage of each chemical component will be adjusted to equivalent gallonage at 60° Fahrenheit.

(c) *Refunds relating to fuels.* See section 6427 for rules which relate to the allowance of a refund or credit to a person who uses tax-paid diesel, special motor or noncommercial aviation fuel to produce a partially exempt methanol or ethanol fuel and section 6416 for rules which relate to the allowance of a refund or credit to a person who uses tax-paid gasoline to produce a partially exempt methanol or ethanol fuel.

(d) *Later blending.* If a partially exempt methanol or ethanol fuel is blended with other motor fuel in a mixture less than 85 percent of which consists of alcohol, the subsequent sale or use of such blended motor fuel is taxable under the provisions of section 4041(a) or section 4081(a), subject to the requirements, limitations and exemptions of those sections.

(e) *Effective date.* Section 4041(m) applies to sales and uses after July 31, 1984. If methanol or ethanol fuel meeting the requirements of paragraph (b) of this section was put into the tank of a vehicle prior to August 1, 1984, the fuel is considered used prior to that date and is subject to the tax described in paragraph (a) of section 4041.

Par. 5. Section 48.4071-1 is amended as follows:

(a) Paragraph (a) is revised to read as set forth below.

(b) paragraph (b)(1) is revised to read as set forth below.

(c) paragraph (b)(2) is redesignated paragraph (b)(3).

(d) A new paragraph (b)(2) is added to read as set forth below.

§48.4071-1 Imposition and rate of tax.

(a) *Imposition of tax*—(1) *Imposition of tax before January 1, 1984.* Section 4071 imposes a tax at the rates set forth in paragraph (b)(1) of this section on tires made wholly or in part of rubber, inner tubes (for tires) made wholly or in part of rubber and tread rubber which are sold by the manufacturer thereof before January 1, 1984.

(2) *Imposition of tax after December 31, 1983.* Section 4071 imposes a tax at the rates set forth in paragraph 9(b)(2) of this section on tires of the type used on highway vehicles and made wholly or in part of rubber which are sold by the manufacturer thereof after December 31, 1983.

(3) *Definitions.* For definitions of the terms "tires," "inner tubes," "tread rubber," "rubber" and "manufacturer," see §48.4072-1 of the regulations.

(b) *Rates and computation of tax*—(1) *Rates of tax before January 1, 1984.*

(i)	*Tires:*		
	(A)	Of the type used on highway vehicles:	
		(1) For the period July 1, 1965 to December 31, 1980, inclusive	10 cents per pound
		(2) For the period January 1, 1981 to December 31, 1983, inclusive . .	9.75 cents per pound
	(B)	Of the type used on other than highway vehicles	
		(1) For the period July 1, 1965, to December 31, 1980, inclusive . .	5 cents per pound
		(2) For the period January 1, 1981 to December 31, 1983, inclusive . .	4.875 cents per pound
	(C)	Laminated tires for the period July 1, 1965 to December 31, 1983, inclusive	1 cent per pound
(ii)	Inner tubes:		
		For the period July 1, 1965 to December 31, 1983, inclusive	10 cents per pound

(iii)	Tread Rubber:		
		For the period July 1, 1965 to December 31, 1983, inclusive	5 cents per pound
(2)	*Rates of tax on or after January 1, 1984.* Tires of the type used on highway vehicles:		
	(i)	Tires weighing not more than 40 pounds	0 cents
	(ii)	Tires weighing more than 40 pounds but not more than 70 pounds	15 cents for each pound in excess of 40 pounds
	(iii)	Tires weighing more than 70 pounds but not more than 90 pounds	$4.50 plus 30 cents for each pound in excess of 70 pounds
	(iv)	Tires weighing more than 90 pounds	$10.50 plus 50 cents for each pound in excess of 90 pounds

* * * * *

Par. 6. Paragraph (b) of §48.4071-2 is retitled "*Alternative method of determining the weight of tires after December 31, 1983*" and is amended by removing "and inner tubes" wherever it appears and by removing in the first sentence the phrase "shown in schedules published by the tire industry".

Par. 7. Section 48.4081-2 is amended as follows:

(a) Paragraph (a) is revised to read as set forth below.

(b) Paragraph (b) is revised to read as set forth below.

(c) The heading of paragraph (c) is revised to read as set forth below.

(d) Paragraph (c)(1) is amended by removing the first sentence of the paragraph and inserting in lieu thereof the sentence set forth below and by removing the word "exempt" in the fifth sentence.

(e) Paragraph (c)(2) is revised by removing "tax free" wherever it appears and inserting in lieu thereof "'at the reduced rate (or tax free for sales before April 1, 1983)".

(f) Paragraph (e)(1) is revised to read as set forth below.

(g) Paragraph (e)(2) is retitled to read as set forth below and is amended by removing the last sentence of the paragraph and inserting in lieu thereof the two sentences set forth below.

(h) A new paragraph (e)(3) is added to read as set forth below.

(i) Paragraph (f)(1) is retitled and is revised to read as set forth below.

(j) The heading and text of paragraph (f)(2) are amended by inserting "and less than 85 percent alcohol" after "40 percent alcohol" wherever it appears.

(l) A new paragraph (f)(3) is added to read as set forth below.

(m) Paragraph (g) is revised to read as set forth below.

(n) Paragraph (h) is revised by removing "tax free" wherever it appears and inserting in lieu thereof "at the reduced rate (or free for sales before April 1, 1983)".

(o) Paragraph (i) is removed.

§48.4081-2 Gasoline mixed with alcohol.

(a) *In general*—(1) *Sale after March 31, 1983, and before October 1, 1988.* Under section 4081(c), the rate of tax applicable to the sale of qqualifying gasohol (as defined in paragraph (a)(4) of this section) and on the sale of gasoline for the purpose of producing qualifying gasohol is:

(i) For sales occurring after December 31, 1984, and before October 1, 1988, 3 cents per gallon of fuel in the case of the sale of qualifying gasohol and 3 ⅓ cents per gallon of fuel in the case of the sale of gasoline purchased for the purpose of producing qualifying gasohol.

(ii) For sales occurring after March 31, 1983, and before January 1, 1985, 4 cents per gallon of fuel in the case of the sale of qualifying gasohol and 4¾ cents per gallon of fuel in the case of the sale of gasoline purchased for the purpose of producing qualifying gasohol.

(2) *Sale before April 1, 1983.* For sales before April 1, 1983 no tax is imposed upon the sale of qualifying gasohol or on the sale of gasoline to produce qualifying gasohol.

(3) *Alcohol defined.* For purposes of this section and section 4081(c), the term "alcohol" generally includes methanol, ethanol, and any other alcohol, whether produced domestically or imported, which is not produced from petroleum, natural gas, or coal. In the case of alcohol mixture fuels sold after December 31, 1984, alcohol produced from peat is considered alcohol produced from coal. The term alcohol, for purposes of this section and section 4081(c), does not include alcohol with a proof of less than 190° of proof (determined without regard to added denaturants). Thus, in determining what percentage of any mixture consists of alcohol, the volume of alcohol includes the volume of any impurities that re-

duce the purity of the alcohol to not less than 95% (190 degrees of proof), determined without regard to denaturants, unless such impurities consist of gasoline or the other non-alcohol fuel with which the alcohol is mixed. In addition, the volume of alcohol includes the volume of any denaturants (including gasoline or other non-alcohol fuel denaturants) which are added under any formula approved by the Secretary to the extent that the volume of such denaturants does not exceed 5% of the volume of the alcohol (including the denaturants). If the volume of such denaturants exceeds 5% of the volume of the alcohol, the excess over 5% is considered part of the non-alcohol content of the fuel. For certain requirements imposed on producers of alcohol (ethanol) under chapter 51 of the Code relating to distilled spirits, see 27 CFR part 201. For certain requirements imposed on purchasers of specially denatured alcohol (ethanol), see 27 CFR Part 211.

(4) *Qualifying gasohol.* Qualifying gasohol (hereinafter referred to as gasohol) is a blend of gasoline and alcohol in a mixture at least 10 percent of which is alcohol. The actual gallonage of each component of the gasohol is adjusted to its equivalent gallonage at 60° Fahrenheit in order to determine whether the 10% alcohol requirement has been met.

(b) *Sale of gasoline to produce gasohol.* The sale of gasoline for use in producing gasohol is subject to the provisions of section 4081(c) rather than section 4081(a) only if the sale is in bulk quantities for delivery into a bulk storage tank of a gasohol producer as defined in this paragraph (b). For purposes of this section, the term "gasohol producer" means any person who, in the ordinary course of his or her trade or business, regularly buys gasoline and alcohol in bulk quantities for blending into gasohol for the use in the trade or business or for resale. Thus, an isolated purchase of gasoline for blending into gasohol does not qualify the seller of such gasoline for taxation under section 4081(c) and this section. A person who qualifies as a gasohol producer for purposes of this section will also qualify as a "producer" for purposes of section 4082. Accordingly, the sale of gasoline to a gasohol producer, whether or not for use in producing gasohol, may be exempt from tax under section 4083 (relating to certain exempt sales to producers). If the sale of gasoline for use in producing gasohol is taxed at the rate provided in section 4081(c), no tax will be imposed upon the sale of the gasohol produced with such gasoline. In addition, if the sale of gasoline for use in producing gasohol is taxed at the rate provided in section 4081(c) applicable to sales before January 1, 1985, and such gasoline is blended into gasohol after December 31, 1984, no refund or credit is allowed for the difference between the tax imposed and the lower tax which would have been imposed if such gasoline had been taxed at the rate applicable to sales after December 31, 1984.

(c) *Requirements for gasohol producers purchasing at lower rates or tax free*—(1) *Certificate of Registry.* A person qualifying as a gasohol producer under paragraph (b) of this section who wishes to purchase gasoline taxed at a reduced rate (or exempt from tax in the case of sales prior to April 1, 1983) under section 4081(c)(1)(B) must be registered with the district director for the district in which his principal place of business is located, unless the person is exempt from registration requirements under section 4222(b).* * *

* * * * *

(e) *Special rules*—(1) *Limitation on sales taxed at lower rates.* The reduced rate of tax (or the exemption from tax in the case of sales prior to April 1, 1983) under §4081(c)(1)(B) only applies to the sale of gasoline for use in producing gasohol. Therefore, unless the sale is exempt from tax or is taxed at a reduced rate under another provision of the Code, the producer of the gasoline may sell at the reduced rate of tax provided in section 4081(c), only that portion of the gasoline that is intended for use in producing gasohol.

(2) *Sales to exempt users.* * * * Therefore, where the ultimate vendor sells both tax-paid gasoline and tax-paid gasohol and the sales of the two types of fuel are not clearly distinguished, the producer of the gasoline and gasohol will not be entitled to a full credit or refund with respect to these fuels, if the amounts of each type sold by the ultimate vendor to tax-exempt users cannot be established. If the producer cannot distinguish the amount of each type sold, the credit allowed will be equal to the credit that would have been allowed if all the fuel sold had been tax-paid gasohol.

(3) *Later blending.* If gasohol is blended with other motor fuel, the subsequent sale or use of such blended motor fuel is taxable under the provisions of section 4041(a) or 4081(a) if the resulting blend is less than 10% alcohol by volume.

(f) *Refunds and credits*—(1) *Tax-paid gasoline under section 4081(a) used to produce gasohol.* See section 6427(f) for rules which relate to the allowance of a refund or credit to a blender of gasohol where the blender uses tax-paid gasoline to produce the gasohol.

* * * * *

(3) *Mixture of gasoline and alcohol containing at least 85% alcohol.* If a person uses tax-paid gasoline in blending a mixture of gasoline and alcohol containing at least 85% alcohol by volume that qualifies for the exemption from tax under section 4041(b)(2) for qualified methanol or ethanol fuels, the refund provisions under section 6416 apply.

(g) *Later separation and failure to blend*—(1) *In general.* Any person who fails to use gasoline which was taxed at a reduced rate (or was exempt from tax in the case of sales prior to April 1, 1983) under section 4081(c) to make gasohol or who separates gasoline from gasohol which was taxed, if at all, under section 4081(c), is treated as a producer of gasoline (as defined under section 4082), and is subject to tax upon the subsequent sale of such gasoline. If gasoline is purchased under section 4081(c) for use in producing gasohol, and the amount purchased is in excess of the amount of gasoline that the purchaser is able to establish has actually been used to produce gasohol by the records required under paragraph (h)(3) of this section, then the purchaser is treated as having failed to use the excess gasoline to produce gasohol. In such a case, any of the excess gasoline that is not in the purchaser's possession is treated as having been disposed of by sale or by a use considered a sale. See section 7201 for criminal penalties relating to a willful attempt to evade or defeat tax, and section 6651 for addi-

tions to tax for failure to file a return or pay tax.

(2) *Rates of tax.* If gasoline or gasohol described in the preceding paragraph was purchased tax free prior to April 1, 1983, the person who is treated as separating the gasohol or failing to use the gasoline to produce gasohol is taxed as a producer at the applicable rate of tax in effect under section 4081(a) at the time of the sale of the gasoline by such person. If the gasoline or gasohol was purchased at the rate of tax applicable to sales after March 31, 1983, and before January 1, 1985, the rate of tax imposed upon the person treated as separating the gasohol or failing to use the gasoline to produce gasohol is 4⅘ cents per gallon. If the gasoline or gasohol was purchased at the reduced rate of tax applicable to sales after December 31, 1984, the rate of tax imposed upon the person treated as separating the gasohol or failing to use the gasoline to produce gasohol is 5⅔ cents per gallon.

(3) *Examples.* The requirements of this paragraph are illustrated by the following examples.

Example (1). A gasohol blender *X* produces 10,000 gallons of gasohol using 9,000 gallons of gasoline and 1,000 gallons of alcohol. Because of a lack of demand for the gasohol, *X* separates the gasoline and sells it. *X* will be treated as the producer of the gasoline.

(i) If the gasoline was previously subject to a 9 cents per gallon tax under section 4081(a), or $810, the sale of the separated gasoline is not subject to any additional tax.

(ii) If the gasoline was previously subject to a 4⅘ cents per gallon tax under section 4081(c), or $400, *X* will be subject to a 4⅘ cents per gallon tax upon the sale of gasoline, or $410.

(iii) If the gasoline was previously subject to a 3⅓ cents per gallon tax under section 4081(c), or $300, *X* will be subject to a 5⅔ cents per gallon tax upon the sale of gasoline, or $510.

(iv) Assume that *X* never blended the 9,000 gallons into gasohol but instead sold the gasoline. *X* will be treated as the producer of the gasoline. If the gasoline had been subject to a 9 cents per gallon tax, *X* will not be subject to any additional tax. If the gasoline had been taxed at a rate of 4⅘ cents per gallon, or $400, X will be subject to a 4⅘ cents per gallon tax upon the sale of the gasoline, or $410. If the gasoline had been taxed at a rate of 3⅓ cents per gallon, or $300, *X* will be subject to a 5⅔ cents per gallon tax upon the sale of the gasoline, or $510.

Par. 8. Section 48.6420-4 (l) is revised by inserting "or other applicator" after "an aerial applicator" wherever it appears.

Par. 9. Section 48.6427-1(a)(2)(iv) is revised by inserting "or other applicator" after "an aerial applicator" wherever it appears.

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on August 21, 1985, 8:45 a.m., and published in the issue of the Federal Register for August 22, 1985, 50 F.R. 33977)

Notice of Proposed Rulemaking

Registration Requirements with Respect to Certain Debt Obligations; Sanctions on Issuers of Registration-Required Obligations Not in Registered Form; and the Application of the Repeal of 30 percent Withholding by the Tax Reform Act of 1984

LR-151-83 and LR-179-84

SUMMARY: This document provides an amended notice of proposed rulemaking relating to the definition of the term "registration-required obligation" with respect to certain types of obligations, relating to the imposition of sanctions on issuers issuing registration-required obligations in bearer form, and relating to the repeal of the 30 percent withholding tax on certain types of interest by the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. This document amends notices of proposed rulemaking published in the Federal Register at 49 FR 33275, and 49 FR 33276. * * * [T]he Internal Revenue Service is issuing amendments to temporary income tax regulations relating to the definition of the term "registration-required obligation" with respect to certain obligations, the imposition of sanctions of issuers issuing registration-required obligations in bearer form, and the repeal of 30 percent withholding by the Tax Reform Act of 1984. The text of those amended temporary regulations serve as the comment document for this notice of proposed rulemaking.

DATES: Written comments and requests for a public hearing must be delivered or mailed before October 21, 1985.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-151-83 and LR-179-84).

FOR FURTHER INFORMATION CONTACT: P. Ann Fisher of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T [LR-151-83 and LR-179-84], 202-566-3289.

SUPPLEMENTARY INFORMATION:

BACKGROUND

The temporary regulations published * * * [on page 61, this Bulletin] amend existing temporary regulations by adding paragraph (d) to §1.163-5T, revising subdivisions (v) and (vi) of §§1.163-5T(c)(2), revising Q&As 10, 12, 14, and 15 of §35a.9999-5(b), and adding paragraph (d) to §35a.9999-5 consisting of Q&A 20. For the text of the temporary regulations, see FR Doc. 85-19893 [T.D. 8046] published * * * [on page 61, this Bulletin].

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although this document is a notice of a proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations as final regulations, consideration will be given to any written comments that are submitted (preferably eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

DRAFTING INFORMATION

The principal author of this regulation is P. Ann Fisher of the Legislation

and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of substance and style.

* * * * *

Proposal of regulations

The temporary regulations, FR Doc. 85-19893 [T.D. 8046] published * * * [on page 61, this Bulletin], are hereby also proposed as final regulations under sections 163, 871, and 881 of the Internal Revenue Code of 1954.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on August 16, 1985, 10:29 a.m., and published in the issue of the Federal Register for August 20, 1985, 50 F.R. 33552)

Notice of Proposed Rulemaking

Limitation on Amount of Depreciation and Investment Tax Credit for Luxury Automobiles; Limitation When Certain Property is Used for Personal Purposes

LR-145-84

SUMMARY: * * * [T]he Internal Revenue Service is issuing temporary income tax regulations under section 274 and amending other temporary regulations under sections 162 and 280F. The temporary regulations under section 274 provide rules for the substantiation of any deduction or credit claimed with respect to traveling away from home, certain entertainment expenditures, business-related gifts, and "listed property." The amendments to the temporary regulations under section 162 relate to the deductibility of certain expenses incurred by employers and employees with respect to noncash fringe benefits. The amendments to the temporary regulations under section 280F provide new limitations on the deductions of lessees of passenger automobiles. The text of the new and amended temporary regulations serves as the comment document for the notice of proposed rulemaking contained in this document.

DATES: Proposed effective dates: The regulations under section 162 are proposed to be effective as of January 1, 1985. The regulations under section 274 relating to the substantiation of deductions and credits claimed with respect to certain business expenditures are proposed to be effective generally for taxable years beginning after December 31, 1985. The amendments relating to the limitations on the deductions of lessees of passenger automobiles are proposed to be effective generally for automobiles leased after April 2, 1985.

Dates for comments and requests for a public hearing: Written comments and requests for a public hearing must be delivered or mailed by January 5, 1986.

ADDRESS: Send comments and request for a public hearing to Commissioner of Internal Revenue, Attention CC:LR:T (LR-145-84), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Michael A. Dazé of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (202-566-6456, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

The temporary regulations published * * * [on page 93, this Bulletin] amend the Income Tax Regulations (26 CFR Part 1) to reflect amendments to section 274 of the Internal Revenue Code of 1954, relating to substantiation requirements, and to section 280F relating to limitations on cost recovery deductions and the investment tax credit allowed for passenger automobiles. The temporary regulations issued under section 274 reflect amendments to section 274(d) by section 179 of the Tax Reform Act of 1984 (Pub. L. 98-369, 98 Stat. 494) [1984-3 C.B. (Vol. 1) 1, 221] and by sections 1(a) and 2 of the Repeal of Contemporaneous Recordkeeping Requirements (Pub. L. 99-44, 99 Stat. 77) [page 350, this Bulletin]. The amendments to the temporary regulations under section 280F reflect amendments to that section by section 4 of Public Law 99-44. The preamble to the temporary regulations contains an explanation of the provisions of those regulations. The temporary regulations will remain in effect until superseded by final regulations which are proposed to be based on the temporary regulations.

Before amendment by the Tax Reform Act of 1984 and Public Law 99-44, section 274(d) required that any deduction for expenses incurred for (1) traveling away from home, (2) entertainment, amusement, or recreation activities or the use of a facility in connection with those activities, or (3) business-related gifts be substantiated by adequate records or sufficient evidence corroborating a taxpayer's own statement. Section 274(d) did not apply to vehicles when used in local travel. Instead, the more general substantiation standards under section 162 were applicable. As amended, section 274(d) requires, for taxable years beginning after December 31, 1985, that any deduction or credit claimed for the expenses described above and for expenses incurred with respect to "listed property" be substantiated by adequate records or sufficient evidence corroborating a taxpayer's own statement. Section 274(d) will then apply to vehicles used in local travel.

First adopted by Treasury decision in 1962, §1.274-5 of the income Tax Regulations reflects the addition of section 274(d) to the Code. Amendments to §1.274-5 are proposed to conform the regulations to the 1984 Act and to Public Law 99-44. For the convenience of taxpayers who must comply with the section 274(d) substantiation requirements, the proposed amendments are incorporated into §1.274-5 and published in full in the format of a temporary regulation. New material is indicated by underlining.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before these proposed amendments are adopted, consideration will be given to any written comments that are submitted (preferably eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying.

Comments are invited, however, on only those portions of new temporary §1.274-5T that are amendments to §1.274-5 to reflect the recent legislation. Specifically, comments are invited on the following provisions that are included among those amendments:

Paragraph (b)(6), the elements of an expenditure or use with respect to listed property,

Paragraph (c)(2)(ii)(C), substantiation of business use,

Paragraph (c)(3)(ii), sampling rule for the substantiation of business use,

Paragraph (c)(6)(i)(C), aggregation of business use,

Paragraph (d)(2) and (3), disclosure on tax returns of certain information with respect to the use of listed property,

Paragraph (e), substantiation of working condition fringe exclusions and certain employee deductions, and

Paragraph (k), other vehicles that may be designated as qualified nonpersonal use vehicles.

Comments are also invited on the provisions of §1.162-25T and §1.274-6T and the amendments to the temporary regulations under section 280F. Comments have been received previously on the limitations applicable to lessees contained in §1.280F-5T of those temporary regulations. The comments have pointed out that separate limitations are not applicable to lessees to whom lessors have elected to pass through the investment credit. The Internal Revenue Service intends to issue an announcement in the near future providing separate limitations for these lessees.

In the case of a fleet of vehicles owned or leased by an employer and used by employees in connection with the employer's business, the Service is considering an alternative method for the employer to satisfy its substantiation requirements. An employer would be able to establish the business use of each vehicle in the fleet and the personal use by an employee by a method similar to the following:

(1) The employer would identify a class of at least 100 vehicles that are physically similar and that are used in a similar fashion,

(2) No vehicle in the class would have a fair market value greater than $16,500,

(3) At the beginning of each taxable year, the employer would select from the class a random sample using accepted sampling techniques,

(4) The sample size would preferably be at least 250 vehicles, or one-half the class in the case of fleets of less than 500 vehicles (but in no event less than 50 vehicles),

(5) The taxpayer would determine the business use of each vehicle in the sample from adequate records maintained for each vehicle, and

(6) The average of the business use of each vehicle in the sample would be the business use of each vehicle in the class.

Comments are invited with respect to this alternative method of satisfying the substantiation requirements of section 274(d).

A public hearing will be held upon written request to the Commissioner by any person who submits written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

The collection of information requirements contained in the temporary regulations have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs, Attention: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on the requirements to OMB also send copies of those comments to the Service.

EXECUTIVE ORDER 12291 AND REGULATORY FLEXIBILITY ACT

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required.

Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

DRAFTING INFORMATION

The principal author of this document is Michel A. Dazé of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other officers of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 1, 1985, and published in the issue of the Federal Register for November 6, 1985, 50 F.R. 46088)

Withdrawal of Notice of Proposed Rulemaking

Substantiation of Certain Deductions and Credits for Business Expenses; Taxation of Fringe Benefits

LR-145-84 and LR-216-84

SUMMARY: This document withdraws portions of two notices of proposed rulemaking by cross reference to temporary regulations published in the FEDERAL REGISTER for February 20, 1985 (50 FR 7071 and 7073) [LR-145-84 and LR-216-84, 1985-1 C.B. 649, 655], relating to the requirement to substantiate certain deductions and credits with "adequate contemporaneous records" and to the taxation of fringe benefits. The text of temporary income tax regulations under sections 132 and 274 served as the comment document for the notices of proposed rulemaking. Changes to the applicable tax law were made by Public Law 99-44, Repeal of Contemporaneous Recordkeeping Requirements [page 350, this Bulletin], that made, *inter alia*, sections of the temporary regulations ineffective. * * * [T]he Internal Revenue Service, therefore, is removing portions of those temporary regulations. This document withdraws those portions of the notices of proposed rulemaking that pertain to the removed temporary regulations.

DATES: The withdrawal of portions of the two notices of proposed rulemaking is generally effective for taxable years beginning after December 31, 1984.

FOR FURTHER INFORMATION CONTACT: Michel A. Dazé (202;566-3839) or Annette J. Guarisco

(202-566-3918) of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, D.C. 20224.

SUPPLEMENTARY INFORMATION:

BACKGROUND

Sections 179 and 531 of the Tax Reform Act of 1984 (Pub. L. 98-369, 98 Stat. 718 and 877) (the 1984 Act) [1985-3 C.B. (Vol. 1), 1, 221, 385] made various amendments to Code sections 61, 274, 3121, 3231, 3306, 3401, and 3501, and added new Code sections 132, 280F, and 4977. Temporary regulations published in the FEDERAL REGISTER on October 24, 1984 (49 FR 42701) [T.D. 7986, 1984-2 C.B. 64] amended the Income Tax Regulations (26 CFR Part 1) to reflect amendments to section 274(d) of the Internal Revenue Code, relating to substantiation requirements, and the addition of section 280F to the Code, relating to the limitations on cost recovery deductions and the investment tax credit for certain property. Other temporary regulations published in the FEDERAL REGISTER for January 7, 1985 (50 FR 747) [T.D. 8004, 1985-1 C.B. 23] amended Parts 1, 31, and 54 of Title 26 of the Code of Federal Regulations, to reflect other amendments to the Code by the 1984 Act relating to the taxation of fringe benefits. Amendments to both sets of temporary regulations and a new temporary regulations relating to the substantiation requirements were published in the FEDERAL REGISTER for February 20, 1985 (50 FR 7038) [T.D. 8009, 1985-1 C.B. 82].

Section 1(a) of Public Law 99-44, Repeal of Contemporaneous Recordkeeping Requirements (the 1985 Act) [page 350, this Bulletin], amended section 274(d) and section 1(c) of the same law made ineffective any regulations issued to carry out certain of the amendments made by the 1984 Act. * * * [T]he Internal Revenue Service is removing those sections of the temporary regulations that are no longer effective. Because the text of the temporary regulations served as the comment document for two notices of proposed rulemaking, the portions of the notices of proposed rulemaking that pertain to the removed temporary regulations must also be withdrawn. This document has no effect on the portions of the two notices of proposed rulemaking that pertain to the temporary regulations under section 280F or on the temporary income, employment, and excise tax regulations relating to the taxation of fringe benefits that are not removed. For discussion of the substantiation requirements under section 274(d) and the rules relating to the taxation of fringe benefits that remain in effect, see the preamble to the removal of the temporary regulations * * * [on page 90, this Bulletin].

DRAFTING INFORMATION

The principal authors of this document are Michel A. Dazé and Annette J. Guarisco of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing this document on matters of both substance and style.

The proposed amendments to 26 CFR Part 1 relating to the "adequate contemporaneous record" requirement and the proposed amendments to 26 CFR Part 1 that would have conformed the regulations relating to the taxation of fringe benefits to the "adequate contemporaneous record" requirement, published in the FEDERAL REGISTER for February 20, 1985 (50 FR 7071 and 7073) [LR-145-84 and LR-216-84, 1985-1 C.B. 649, 655], are hereby withdrawn.

JAMES I. OWENS,
Acting Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 1, 1985, 8:45 a.m., and published in the issue of the Federal Register for November 6, 1985, 50 F.R. 46086)

Notice of Proposed Rulemaking Employee Tip Reporting and Substantiation Requirements

LR-162-84

SUMMARY: * * * [T]he Internal Revenue Service is issuing temporary employment tax regulations relating to the reporting and substantiation requirements applicable to tipped employees. The text of the temporary regulations serve as the comment document for this notice of proposed rulemaking.

DATES:

PROPOSED EFFECTIVE DATE

The proposed amendments with respect to a lower allocation-of-tips percentage would be effective on and after July 18, 1984. The provisions relating to the definition of a large food or beverage establishment would be effective for taxable years beginning after December 31, 1982. The substantiation requirements would be effective with respect to tips received on or after October 1, 1985.

DATES FOR COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Written comments and requests for a public hearing must be delivered or mailed by September 23, 1985.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-162-84) Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Gail H. Morse of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224, Attention: CC.LR:T (202-566-3297, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

The temporary regulations * * * [on page 316, this Bulletin] amend the Employment Tax Regulations (26 CFR Part 31) under section 6053.

For the text of the temporary regulations see T.D. 8039 * * * [on page 316, this Bulletin]. The preamble to the temporary regulations explains the addition to the regulations.

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the

regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection copying. A public hearing will be held upon written requests to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER. The collection of information requirements contained herein have been submitted for OMB review under the Paperwork Reduction Act, and comments on them should be sent to the Office of Information and Regulatory Affairs of OMB, Attn: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests persons submitting comments to OMB to also send copies of the comments to the Service.

DRAFTING INFORMATION

The principal author of these proposed regulations is Gail H. Morse of the Legislation and Regulations Division of the Office of the Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on July 18, 1985, 4.06 p.m., and published in the issue of the Federal Register for July 23, 1985, 50 F.R. 29990)

Notice of Proposed Rulemaking

Below-Market Loans

LR-165-84

SUMMARY: This document contains proposed regulations relating to the Federal tax treatment of both the lender and the borrower in certain below-market interest rate loan transactions. Changes to the applicable tax law were made by the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. These regulations would affect taxpayers who enter into certain below-market loans and provide them with guidance needed to comply with the law.

DATES: Written comments and requests for a public hearing must be delivered or mailed by October 21, 1985. The regulations are generally proposed to be effective after June 6, 1984, for below-market term loans made after June 6, 1984, and below-market demand loans outstanding after June 6, 1984. Section 1.7872-1(c) provides special effective date rules for certain loan transactions.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-165-84), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Sharon L. Hall of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3828 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1), the Estate Tax Regulations (26 CFR Part 20), the Gift Tax Regulations (26 CFR part 25) and the Excise Tax Regulations (26 CFR Part 53) under section 7872 of the Internal Revenue Code of 1954. This document also amends the Table of OMB Control Numbers (26 CFR Part 602). These amendments are proposed to provide regulations under new section 7872, which was added to the Code by section 172 of the Tax Reform Act of 1984 (98 Stat. 699) [Pub. L.98-369, 1984-3 C.B. (Vol. 1) 1, 207].

IN GENERAL

Prior to the enactment of section 7872, some taxpayers used interest-free loans or loans with an interest rate below the current market rate (in each case, "below-market loans") which purported to circumvent well-established rules of taxation. Thus, in family or similar situations, below-market loans have been used which purported to have the effect of avoiding taxation under the grantor trust rules and deflecting income to others. Corporations have made below-market loans to shareholders with the effect of avoiding taxation of income at the corporate level which is the economic equivalent of receiving a deduction for dividends paid to those shareholders. Employers have made below-market loans to employees with the effect of providing compensation which has not been subject to employment taxes. Interest-free loans have also been used to convert non-deductible expenses into the equivalent of deductible expenses.

Section 7872 addresses these and similar practices, generally, by treating certain below-market loans described in one of the categories specified in section 7872(c) as economically equivalent to loans bearing interest at the applicable Federal rate coupled with a payment by the lender to the borrower sufficient to fund the payment of interest by the borrower. Thus, the lender is treated as making (i) a loan to the borrower in exchange for a note requiring the payment of interest at the applicable Federal rate, and (ii) a transfer of funds to the borrower in an amount generally equal to the amount of interest imputed under section 7872. In the case of term gift loans, however, the amount of money treated as transferred by the lender to the borrower, which is subject to gift tax, and the amount of the imputed interest payment by the borrower to the lender are unequal because they are computed differently under the statute.

CHARACTER AND TIMING OF TRANSFERS

The character of the imputed transfer by the lender to the borrower is determined in accordance with the substance of the transaction. For example, the transfer is treated as a gift if the trans-

action is in substance a gift within the meaning of the gift tax provisions of the Code, and it is treated as compensation if the purpose of the transaction is the payment of compensation. This imputed transfer is computed annually and in the case of demand loans is treated as made, generally, on December 31. In the case of term loans, however, the imputed transfer is treated as made at the time the loan is made.

The timing and amount of the imputed interest payments by the borrower to the lender depend on the character of the amount transferred by the lender to the borrower and on whether the loan is a term loan or a demand loan. The imputed interest payment in the case of gift and demand loans is computed annually and generally is treated as transferred on December 31. The imputed interest payment in the case of term loans other than gift loans is computed on the date the loan is made and is subject to the original issue discount rules of section 1272.

DEFINITION OF LOAN

Because the purpose of section 7872 is to eliminate the use of below-market loans as a vehicle for tax avoidance, the term "loan" is interpreted broadly in the regulations. Accordingly, any extension of credit or any transaction under which the owner of money permits another person to use the money for a period of time after which the money is to be transferred back to the owner or applied according to an agreement with the owner, such as a refundable deposit, is a loan for purposes of section 7872. However, only those below-market loans that are gift loans, compensation-related loans, corporation-shareholder loans, tax avoidance loans or loans to be specified as significant-effect loans (see below), are subject to the provisions of section 7872. Proposed §1.7872-4(g) provides a special rule for a below-market loan which is made between two persons and is attributable to the relationship of a third person to either the lender or the borrower (for example, a loan by an employer to the child of an employee). In this case, the loan is restructured as two successive "indirect" loans for purposes of section 7872. In addition, the regulations provide that if a lender and a borrower use another entity as an intermediary or middleman, such as in a "back-to-back" loan transaction, for the purpose of avoiding the application of section 7872, the intermediary will be ignored and the two loans will be restructured as one loan made directly between the lender and the borrower.

Section 7872(c)(1)(B)(ii) states that loans between an independent contractor and a person for whom the independent contractor provides services are subject to section 7872. In addition, the proposed regulations define a loan to include any transaction which would be treated as a refundable deposit under current law. Accordingly, if a taxpayer makes a refundable deposit to an independent contractor in connection with the performance of services, the deposit will be subject to the imputation rules of section 7872 (unless the *de minimis* rules are applicable). The Service is aware that cash amounts are frequently deposited with independent contractors in the ordinary course of business and characterized by the parties as prepayments rather than refundable deposits. Consequently, if this characterization is appropriate, those amounts would not be subject to section 7872. The proper distinction between refundable deposits and prepayments is a factual determination, and, to assist the Service in developing guidelines for drawing this distinction, interested parties are invited to comment on this issue.

PARTNERSHIPS AND PARTNERS

The Service is aware that some taxpayers have entered into below-market loans with partnerships and that other taxpayers have achieved the economic and tax result afforded a below-market loan transaction by utilizing partnerships and the tax laws under subchapter K. The proposed regulations provide that certain below-market loans made by a partnership to a partner that are made in consideration for services performed by the partner other than in his capacity as a member of the partnership will be treated as compensation-related loans for purposes of section 7872.

The final regulations under section 7872 will further address the relationship of section 7872 to partnership transactions, such as certain purported distributions which, under the facts and circumstances, may properly be characterized as loans. The Service is considering several proposals regarding the application of section 7872 to transactions between partners and partnerships and requests interested taxpayers to submit written comments on this point.

SIGNIFICANT EFFECT LOAN

In addition to the four enumerated categories of below-market loans, section 7872(c)(1)(E) provides regulatory authority for applying section 7872 to any other below-market loan if "the interest arrangements of such loan have a significant effect on any Federal tax liability of the lender or the borrower." The Conference Report accompanying the Tax Reform Act of 1984 states, among other things, that any loan that results in the conversion of a nondeductible expense into the equivalent of a deductible expense has an effect on the tax liability of the borrower or lender. The Conference Report further provides that whether an effect is significant is determined in light of all the facts and circumstances including:

(1) Whether the items of income and deduction generated by the loan offset each other;

(2) The amount of such items;

(3) The cost to the taxpayer of complying with the provision; and

(4) Any non-tax reasons for deciding to structure the transaction as a below-market loan rather than a loan with interest at a rate equal to or greater than the applicable Federal rate and a payment by the lender to the borrower.

The Service is aware of numerous situations in which below-market loans have the potential to convert nondeductible personal expenses into the equivalent of deductible expenses. This potential is particularly apparent where interest earned on the borrowed amount may be used to compensate (or provide additional compensation to) the borrower for services or property provided to the lender. Examples of these situations include:

(1) Loans to a membership organization in lieu of part or all of a membership fee;

(2) Loans to institutions providing meals, lodging, and/or medical services (*e.g.*, continuing care facilities) in lieu of fees for such services;

(3) Loans to colleges and secondary schools in lieu of part or all of the tuition, room, and board that would other-

wise be charged; and

(4) Loans to an employee or independent contractor by an employer in lieu of payment for a service provided to such employer by the employee (*e.g.*, housing, life insurance coverage, health care).

Many of these transactions have a significant potential for distortion of tax liability, especially if the amounts loaned are relatively large. The Service has decided, however, not to propose regulations treating transactions as having a significant effect until further comment is received on how the facts and circumstances test should be applied, including the proper role of the factors cited by the Conference Report. The Service intends to hold a hearing after publication of these proposed regulations, if a public hearing is requested by any person who submits written comments. The Service urges taxpayers to submit written comments and to speak on this point at that hearing. No transaction will be treated under the regulations as a significant effect loan earlier than the date that future regulations under section 7872(c)(1)(E) are published in proposed form.

EXCLUSION FROM SECTION 7872

Proposed §§1.7872-7 and 1.7872-8 provide for the exclusion of certain below-market loans from the rules of section 7872. Generally, if the amount of loans between a lender and a borrower does not exceed $10,000, section 7872 does not apply. Furthermore, in the case of gift loans of less than $100,000, directly between natural persons, the imputed interest payment by the borrower to the lender each year generally is limited to the amount of the borrower's net investment income (as defined section 7872(d)(1)(E)) for the taxable year.

In addition, section 7872(g)(1)(C) provides regulatory authority for exempting from the application of section 7872 any class of transactions if the application of section 7872 would not have a significant effect on any Federal tax liability of the lender or the borrower. Accordingly, proposed §1.7872-5 provides that certain below-market loans which are not structured as such for tax avoidance purposes are exempted from the provisions of section 7872. If, however, such a loan is structured as one of the exempted loans for tax avoidance purposes, the Service may recharacterize the transaction according to its economic substance and apply section 7872 in accordance with its terms. Interested taxpayers are invited to comment on whether other transactions should be exempted from section 7872, and on the proper tax treatment under section 7872 of private placements of convertible debt.

Section 7872(f)(8) provides that section 7872 does not apply to any loan to which section 483 or 1274 applies. The regulations clarify that generally section 7872 does not apply to any loan to which section 483 or 1274 could apply even though the rules of those sections do not apply because of exceptions or safe harbor provisions in one of those sections. The regulations further clarify that debt instruments issued for property and payable on demand, debt instruments described in section 1273(b)(3) and debt instruments described in section 1275(b) are not subject to sections 483 and 1274 and are subject to section 7872 if those instruments are described in section 7872(c)(1)(A), (B), or (C).

Certain loans subject to section 7872 are also described in section 482 of the Code (concerning the allocation of income and deductions among related taxpayers). These regulations provide for one limited exception to section 7872 in the case of a loan which is also described in §1.482-2(a)(3), concerning indebtedness arising in the ordinary course of business out of sales, leases, or the rendition of services by or between members of a group outstanding for six months or less (the "open accounts exception"). This limited exception will expire on June 30, 1986, by which time the Service plans to have completed its review of the commercial need for an exception from section 7872 in the case of certain "open account" transactions between parties described in section 7872. The Service invites written comments on this issue.

FOREIGN CURRENCY LOANS

The proposed regulations state that for purposes of applying the below-market loan rules to loans denominated in a foreign currency, a market rate of interest appropriate for that currency shall be used in lieu of the applicable Federal rate. However, the proposed regulations expressly leave open the question of how the imputed transfer from the borrower to the lender is to be treated for tax purposes. The Service is aware that high nominal rates of interest in currencies expected to depreciate with respect to the dollar may overstate the true cost of borrowing to a U.S. taxpayer, if offsetting foreign currency gains are not taken into account. Conversely, low rates of interest in currencies expected to appreciate with respect to the dollar may understate true borrowing costs. The Service is studying this issue further, in the context of transactions governed by section 7872 as well as those governed by sections 1271 through 1275, and plans to address this issue in future regulations under these sections.

REQUEST FOR COMMENTS ON CERTAIN TRANSACTIONS

The Service is aware that numerous transactions which occur in the ordinary course of business in many industries may be characterized under section 7872(c)(1)(B) as compensation-related loans. (One example is a transaction in which a cash margin deposit is made pursuant to requirements of an exchange to a futures commission merchant or to the exchange as a condition for trading futures contracts. See §1.7872-5 for a special temporary rule pending comments.) In order to determine whether these transactions are subject to section 7872 and whether the interest arrangements of such transaction have a significant effect on the Federal tax liability of the lender or borrower, the Service requests that taxpayers submit written comments providing a full explanation of the transactions.

The Service is also aware that other persons subject to section 7872 may enter into numerous short-term demand loans for business-related or other purposes. (One example is short-term loans resulting from the extension of credit through the use of a credit card. See §1.7872-10(a)(6) for a special rule relating to revolving credit loans.) Because of the volume and the short-term nature of the loans in these situations, the Service is also considering whether

special rules of convenience can be formulated in some circumstances to reduce the cost of compliance without creating opportunities for manipulation or tax avoidance. The Service invites comments and suggestions with respect to such possible rules of convenience, the circumstances in which they would be applicable, and any exceptions that may be necessary if such rules are adopted.

APPLICABLE FEDERAL RATE

Under the proposed regulations, the applicable Federal rate in effect at any time depends upon the Federal statutory rates established for semiannual periods and the alternate Federal rates established by the Commissioner on a monthly basis (see §1.1274-3T). The Federal statutory rates and the alternate Federal rates are published by the Commissioner along with equivalent rates which are based on different compounding periods. The choice of the appropriate Federal statutory rate or alternate Federal rate for any loan depends upon the payment intervals or compounding periods required under the loan agreement. The regulations provide special rules to permit use of the alternate Federal rate in the case of demand loans. In addition, the proposed regulations provide special rules for certain variable interest rate loans.

UNASCERTAINABLE TERM

The proposed regulations do not address the treatment of term loans in the case where the period for which the loan is outstanding is unascertainable. For example, a loan which must be repaid when the borrower marries is a term loan outstanding for an unascertainable period of time. In order to make the calculations required by section 7872(b), it is necessary to know the period of time that the term loan is outstanding. The Service invites comments on this issue.

OTHER ISSUES: CONSISTENCY; ESTATE AND GIFT TAX RULES; PRIVATE FOUNDATIONS

Section 7872(g)(1)(B) provides regulatory authority for assuring that the positions of the lender and borrower are consistent as to the application or nonapplication of section 7872. Accordingly, proposed §1.7872-11(f) provides that the lender and the borrower each must attach a statement to their income tax returns for any taxable year in which they either have imputed income or claim a deduction for an amount imputed under section 7872.

In addition, proposed §20.7872-1 implements section 7872(g)(2) by prohibiting the discounting, at other than the applicable Federal rate, for estate tax purposes, of any term loan made by a decedent with donative intent after June 6, 1984. Proposed §25.7872-1 implements section 7872(a) by providing that the amount transferred by the lender to the borrower and characterized as a gift is subject to the gift tax provisions. Finally, §53.4941(d)-2 is amended to provide that the amount of interest on loans between a disqualified person and a private foundation is computed without regard to section 7872 for purposes of application of the excise tax imposed by that section.

EFFECTIVE DATES

In general, the provisions of section 7872 apply after June 6, 1984, to term loans made after June 6, 1984, and to demand loans outstanding after June 6, 1984. If, however, a demand loan that was outstanding after June 6, 1984, is retired before September 17, 1984, the provisions of section 7872 will not apply to the demand loan for the period ending on the date on which the loan is retired. For this purpose, the demand loan is retired by repayment, cancellation, forgiveness, modification of the interest arrangement, or some other similar action (see Internal Revenue Service News Release, IR-84-95, published August 28, 1984).

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is to be held, notice of the time and place will be published in the FEDERAL REGISTER.

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required. Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the proposed regulations are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of these proposed regulations is Howard A. Balikov of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

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Proposed Amendments to the regulations

The proposed amendments to 26 CFR Part 1, 26 CFR Part 20, 26 CFR Part 25, and 26 CFR Part 53 are as follows:

INCOME TAX REGULATIONS 26 CFR PART 1

Paragraph 1. The authority for Part 1 is amended by adding the following

citation:

Authority: 26 U.S.C. 7805. * * * §§1.7872-1 through 1.7872-14 also issued under 26 U.S.C. 7872.

Par. 2. New §§1.7872-1 through 1.7872-14 are added in the appropriate place. These new sections read as follows:

§1.7872-1 Introduction.

(a) *Statement of purpose.* Section 7872 generally treats certain loans in which the interest rate charged is less than the applicable Federal rate as economically equivalent to loans bearing interest at the applicable Federal rate, coupled with a payment by the lender to the borrower sufficient to fund all or part of the payment of interest by the borrower. Such loans are referred to as "below-market loans." See §1.7872-3 for detailed definitions of below-market loans and the determination of the applicable Federal rate.

Accordingly, section 7872 recharacterizes a below-market loan as two transactions:

(1) An arm's-length transaction in which the lender makes a loan to the borrower in exchange for a note requiring the payment of interest at the applicable Federal rate; and

(2) A transfer of funds by the lender to the borrower ("imputed transfer").

The timing and the characterization of the amount of the imputed transfer by the lender to the borrower are determined in accordance with the substance of the transaction. The timing and the amount of the imputed interest payment (the excess of the amount of interest required to be paid using the applicable Federal rate, *over* the amount of interest required to be paid according to the loan agreement) by the borrower to the lender depend on the character of the imputed transfer by the lender to the borrower and whether the loan is a term loan or a demand loan. If the imputed transfer by the lender is characterized as a gift, the provisions of chapter 12 of the Internal Revenue Code, relating to gift tax, also apply. All imputed transfers under section 7872 (*e.g.*, interest, compensation, gift) are characterized in accordance with the substance of the transaction, and, except as otherwise provided in the regulations under section 7872, are treated as so characterized for all purposes of the Code. For example, for purposes of section 170, an interest-free loan to a charity referred to in section 170 for which interest is imputed under section 7872, is treated as an interest bearing loan coupled with periodic gifts to the charity in the amount of the imputed transfer, for purposes of section 170. In addition, all applicable information and reporting requirements (*e.g.*, reporting on Form W-2 and Form 1099) must be satisfied.

(b) *Effective date*—(1) *In general.* The provisions of section 7872 generally apply, for periods after June 6, 1984, to demand loans outstanding after that date and to loans other than demand loans made after that date.

(2) *Demand loans repaid before September 17, 1984.* If a demand loan which was outstanding on June 6, 1984, is repaid before September 17, 1984, section 7872 does not apply to the loan. For purposes of this paragraph (b)(2) only, a loan is treated as repaid if it is repaid, cancelled, forgiven, modified, or otherwise retired. For example, if the loan agreement for an interest-free demand loan, which is outstanding on June 6, 1984, is modified on September 10, 1984, to require the borrower to pay a 5 percent simple rate of interest, then for purposes of this paragraph (b)(2) the original loan is treated as repaid on September 10, 1984, and section 7872 applies to the modified loan beginning on that date.

(3) *Change in loan agreement.* For purposes of section 7872, any loan which is renegotiated, extended, or revised after June 6, 1984, is treated as a loan made after June 6, 1984. Accordingly, for purposes of the effective date provisions of this paragraph (b) in the case of such a loan, the provisions of section 17872 apply as if the loan were a new loan made on the day the lender and borrower enter into a binding agreement to change the provisions of the loan.

(4) *Other Federal tax consequences.* Section 7872 does not alter the law applicable to below-market loans for periods prior to the effective date of section 7872. Accordingly, below-market interest rate loans which are not subject to section 7872 by reason of the effective date provisions of this paragraph (b), including loans which are repaid under the rule described in paragraph (b)(2) of this section, may still have Federal tax consequences. *See, e.g., Dickman v. Commissioner*, 465 U.S. ___ (1984), 104 S.Ct. 1086.

(c) *Key to Code provisions.* The following key is intended to facilitate research with respect to specific Code provisions. The key identifies the regulations section in which the principal discussion of a particular Code provision appears. As a result of the interrelationship among Code provisions, other regulation sections may also discuss the particular Code provisions. Section 1.7872-2 deals with the definition of the term "loan" for purposes of section 7872. The following table identifies the provisions of section 7872 that are dealt with in §§1.7872-2 through 1.7872-14 and lists each provision of Code section 7872 below the regulation section in which it is covered.

§1.7872-2		
(f)(8)		
§1.7872-3	*§1.7872-4*	*§1.7872-5*
(e)(1)	(c)(1)	(g)(1)(C)
(f)(2)	(f)(3)	
(g)(1)(A)		
§1.7872-6	*§1.7872-7*	*§1.7872-8*
(a)	(b)	(c)(2)
(d)(2)	(d)(2)	(d)(1)
	(f)(1)	
	(f)(4)	
	(f)(10)	
§1.7872-9	*§1.7872-10*	*§1.7872-11*
(c)(3)	(f)(5)	(f)(7)
(f)(10)	(f)(6)	(f)(9)
		(g)(1)(A)
		(g)(1)(B)
§1.7872-12	*§1.7872-13*	*§1.7872-14*
(e)(1)(A)	(e)(2)	(e)(1)(B)
		(f)(1)

See §20.7872-1 for regulations under section 7872(g)(2).
See §25.7872-1 for gift tax regulations.
See §53.4941(d)-2 for interest-free loans between private foundations and disqualified persons.

§1.7872-2 Definition of loan.

(a) *In general*—(1) *"Loan" interpreted broadly.* For purposes of section 7872, the term "loan" includes generally any extension of credit (including, for example, a purchase money mortgage) and any transaction under which the owner of money permits another person to use the money for a period of time after which the money is to be transferred to the owner or applied according to an express or implied agreement with the owner. The term "loan"

is interpreted broadly to implement the anti-abuse intent of the statute. An integrated series of transactions which is the equivalent of a loan is treated as a loan. A payment for property, goods, or services under a contract, however, is not a loan merely because one of the payor's remedies for breach of the contract is recovery of the payment. Similarly, a bona fide prepayment made in a manner consistent with normal commercial practices for services, property, or the use of property, generally, is not a loan; see section 1461 and the regulations thereunder for the treatment of certain prepaid expenses and for the special rules of sections 461(h) and (i). However, a taxpayer's characterization of a transaction as a prepayment or as a loan is not conclusive. Transactions will be characterized for tax purposes according to their economic substance, rather than the terms used to describe them. Thus, for example, receipt by a partner from a partnership of money is treated as a loan if it is so characterized under §1.731-1(c)(d).

(2) *Limitations on applicability of section 7872*—(i) *In general.* Section 7872 applies only to certain below-market loans (as defined in section 7872(e)(1)). Section 1.7872-4 lists the categories of below-market loans to which section 7872 generally applies. Certain below-market loans within these categories, however, are exempt from the provisions of section 7872. See §1.7872-5 for specific exemptions from the rules.

(ii) *Loans to which section 1483 or 1274 applies.* Generally, section 7872 does not apply to any loan which is given in consideration for the sale or exchange of property (within the meaning of section 1274(c)(1)) or paid on account of the sale or exchange of property (within the meaning of section 483(c)(1)), even if the rules of those sections do not apply by reason of exceptions or safe harbor provisions. Any transaction, however, which otherwise is described in section 7872(c)(1)(A), (B), or (C), and is—

(A) A debt instrument that is issued in exchange for property and that is payable on demand,

(B) A debt instrument described in section 1273(b)(3), or

(C) A debt instrument described in section 12275(b), unless the transaction is described in §1.7872-5(b)(1).

is not subject to sections 483 and 1274 and is subject to section 7872.

(iii) *Relation to section 482.* If a below-market loan subject to section 7872 would also be subject to section 482 if the Commissioner chose to apply section 482 to the loan transaction, then section 7872 will be applied first. If the Commissioner chooses to apply section 482, then the loan transaction is subject to section 482 in addition to section 7872.

(3) *Loan proceeds transferred over time.* In general, each extension of credit or transfer of money by a lender to a borrower is treated as a separate loan. Accordingly, if the loan agreement provides that the lender will transfer the loan proceeds to the borrower in installments, each installment payment is treated as a separate loan. Similarly, in the case of a loan in which the transfer of the loan proceeds to the borrower is subject to a draw-down restriction, each draw-down of loan proceeds is treated as a separate loan.

(b) *Examples of transactions treated as loans.*–(1) *Refundable Deposits*—(i) *In general.* If an amount is treated for Federal tax purposes as a deposit rather than as a prepayment or an advance payment, the amount is treated as a loan for purposes of section 7872.

(ii) *Partially refundable deposits.* If an amount is treated for Federal tax purposes as a deposit rather than as a prepayment or an advance payment and the amount is refundable only for a certain period of time or is only partially refundable, then the deposit is treated as aloan only to the extent that it is refundable and only for the period of time that it is refundable.

(iii) *Exception.* paragraph (b)(1)(i) does not apply if the deposit is custodial in nature or is held in trust for the benefit of the transferor. The deposit is treated as custodial in nature if the transferee is not entitled to the beneficial enjoyment of the amount deposited including interest thereon (except as security for an obligation of the transferor). Thus, if an amount is placed in escrow to secure a contractual obligation of the transferor, and the escrow agreement provides that all interest earned is paid to the transferor and that the transferee has no rights to or interest in the escrowed amount unless and until the transferor defaults on the obligation, then, in the absence of any facts which indicate that the transaction was entered into for tax avoidance purposes, the deposit is not a loan.

(2) *Permitting agent or intermediary to retain funds.* An agreement under which an agent or intermediary is permitted to retain possession of money for a period of time before transferring the money to his or her principal is treated as a loan for purposes of section 7872. For example, a taxpayer who enters into an agreement with a broker under which the broker may retain possession of the proceeds from the sale of the taxpayer's property (*e.g.*, securities issued by the taxpayer) for a period of time and uses or invests those funds (other than for the taxpayer's account) is treated as making a loan to the broker for the period of time that the broker retains possession of the proceeds.

(3) *Advances.* An advance of money to a employee, salesman, or other similar person to defray anticipated expenditures is not treated as a loan for purposes of section 7872 if the amount of money advanced is reasonably calculated not to exceed the anticipated expenditures and if the advance of money is made on a day within a reasonable period of time of the day that the anticipated expenditure will be incurred. An advance or draw of money against a partner's distributive share of income which is treated in the manner described in §1.731–1(a)(1)(ii) is not a loan for purposes of section 7872.

§1.7872-3 Definition of below-market loans

(a) *In general.* Section 7872 does not impute interest on loans which require the payment of interest at the applicable Federal rate. This section defines the applicable Federal rate and provides rules for determining whether an interest-bearing loan provides sufficient stated interest to avoid classification as a below-market loan. The term "below-market loan" means any loan if—

(1) In the case of a demand loan, interest is payable at a rate less than the applicable Federal rate; or

(2) In the case of a term loan, the amount loaned exceeds the present value of all payments due under the loan, determined as of the day the loan is made, using a discount rate equal to

the applicable Federal rate in effect on the day the loan is made.

Sections 1.7872-13 and 1.7872-14 contain the computations necessary for determining the amount of imputed interest on a below-market loan which is subject to section 7872.

(b) *Applicable Federal rate*—(1) *In general.* The applicable Federal rate is an annual stated rate of interest based on semiannual compounding. In addition, the Commissioner may prescribe equivalent rates based on compounding periods other than semiannual compounding (for example, annual compounding, quarterly compounding, and monthly compounding), to facilitate application of this section to loans other than those involving semiannual payments or compounding. Thus, loans providing for annual payments or annual compounding of interest over the entire life of the loan will use the applicable Federal rates based on annual compounding; loans providing for quarterly payments or quarterly compounding over the entire life of the loan will use the applicable Federal rates based on quarterly compounding; and loans providing for monthly payments or monthly compounding over the entire life of the loan will use the applicable Federal rates based on monthly compounding. The shorter of the compounding period or the payment interval determines which rate is appropriate. Loans providing for payments or compounding of interest at other intervals (*e.g.*, daily, weekly, bi-monthly) may use the applicable Federal rates published by the Commissioner based on the shortest compounding period that is longer than the shorter of the compounding period or the payment interval provided for over the entire life of the loan. Thus, loans providing for daily or weekly payments or compounding of interest may use the applicable Federal rate based on monthly compounding; loans providing for bimonthly payments or compounding of interest will use the applicable Federal rates based on quarterly compounding; etc. Alternatively, taxpayers may compute and use interest rates other than those published by the Commissioner for other interest payment or compounding periods if such rates are equivalent to the applicable Federal rates. Any reference to the applicable Federal rate in the regulations under section 7872 includes the equivalent rates based on different compounding or payment periods.

(2) *Determination of applicable Federal rate*—(i) *In general.* The applicable Federal rate for loans described in paragraphs (b)(3), (4), and (5) of this section is defined by reference to Federal statutory rates and alternate Federal rates.

(ii) *Definition of Federal statutory rate.* The Federal statutory rates are the short-, mid-, and long-term rates in effect under section 1274(d) and their equivalent rates based on different compounding assumptions. These rates are published by the Commissioner for each semiannual period January 1 through June 30 and July 1 through December 31.

(iii) *Definition of alternate Federal rate.* The alternate Federal rates are the short-, mid-, and long-term rates established by the Commissioner on a monthly basis, and their equivalent rates based on different compounding assumptions. These rates are published by the Commissioner on a monthly basis.

(iv) *Definition of semiannual period.* For purposes of section 7872 and the regulations thereunder, the first semiannual period means the period in any calendar year beginning on January 1 and ending on June 30, and the second semiannual period means the period in any calendar year beginning on July 1 and ending on December 31.

(3) *Demand loans*—(i) *In general.* In the case of a demand loan, the applicable Federal rate for a semiannual period (January 1 through June 30 or July 1 through December 31), is the lower of:

(A) The Federal statutory short-term rate in effect for the semiannual period; or

(B) The special rate for demand loans described in paragraph (b)(3)(ii) of this section.

(ii) *Special rate for demand loans.* The special rate for demand loans is—

(A) For the semiannual period in which the loan is made, the alternate Federal short-term rate which is in effect on the day the loan is made; and

(B) For each subsequent semiannual period in which the loan is outstanding, the alternate Federal short-term rate which is in effect for the first month of that semiannual period (*i.e.*, January or July).

For a special safe harbor rule for certain variable interest rate demand loans, see paragraph (c)(2) of this section.

(4) *Term loans.* In the case of a term loan, including a gift term loan or a term loan that is treated as a demand loan as provided in §1.7872-10(a)(5), the applicable Federal rate is the lower of:

(i) The Federal statutory rate for loans of that term in effect on the day the loan is made; or

(ii) The alternate Federal rate for loans of that term in effect on the day the loan is made.

(5) *Loans conditioned on future services.* In the case of a term loan that is treated as a demand loan as provided in §1.7872-10(a)(5), on the date the condition to perform substantial services is removed or lapses, the demand loan is treated as terminated and a new term loan is created. The applicable Federal rate for the new term loan is the lower of the following:

(i) The applicable Federal rate in effect on the day the original loan was made; or

(ii) The applicable Federal rate in effect on the day the condition lapses or is removed.

(6) *Periods before January 1, 1985.* For term loans made and demand loans outstanding after June 6, 1984, and before January 1, 1985, the applicable Federal rate under section 7872(f)92) is as follows:

(i) 10.25 percent, compounded annually;

(ii) 10.00 percent, compounded semiannually;

(iii) 9.88 percent, compounded quarterly; and

(iv) 9.80 percent, compounded monthly.

(c) *Loans having sufficient stated interest.*—(1) *In general.* Section 7872 does not apply to any loan which has sufficient stated interest. A loan has sufficient stated interest if it provides for interest on the outstanding loan balance at a rate now lower than the applicable Federal rate based on a compounding period appropriate for that loan. See paragraph (b)(1) of this section for a description of appropriate compounding periods. See §1.7872-11(a) for rules relating to

waiver of interest.

(2) *Safe harbor for demand loans.* If the interest rate on a demand loan is changed, either under the terms of the original loan agreement, or subsequently, the loan will be treated as a new loan for purposes of determining the applicable Federal rate for that loan. Thus, the loan will have sufficient stated interest for the remainder of the semiannual period following such change of interest rate if the new interest rate is not less than the lower of the Federal statutory short-term rate in effect for the semiannual period or the alternate Federal short-term rate in effect on the day the new interest rate takes effect.

(3) *Examples.* The provisions of this paragraph (c) may be illustrated by the following examples.

Example (1). On December 1, 1984, A makes a $100,000 5-year gift term loan to B, requiring 10 interest payments of $5,000 each, payable on May 31 and November 30 of each year the loan is outstanding. Since the loan requires semiannual interest payments, the appropriate compounding assumption is semiannual compounding. For term loans made during 1984, the applicable Federal rate based on semiannual compounding is 10 percent. The loan is not a below-market loan because it provides for interest at a rate of 10 percent, payable semiannually.

Example (2). Assume the same facts as in Example (1), except that the loan requires 5 annual interest payments of $10,000 each, payable on November 30 of each year the loan is outstanding. Since the loan requires annual interest payments, the appropriate compounding assumption is annual compounding. The loan is a below-market loan because, although interest is stated at a rate of 10 percent, a rate that reflects semiannual compounding is not appropriate for a loan with annual payments.

Example (3). Assume the same facts as in Example (2), except that the loan requires 5 annual interest payments of $10,250 each, payable on November 30 of each year that the loan is outstanding. Since the loan requires annual interest payments, the appropriate compounding assumption is annual compounding. For term loans made during 1984, the applicable Federal rate based on annual compounding is 10.25 percent. The loan is not a below-market loan because it provides for interest at a rate of 10.25 percent, compounded annually.

Example (4). Assume the same facts as in Example (1), except that the loan requires 120 monthly interest payments of $816.67 each, payable on the last calendar day of each month that loan is outstanding. Since the loan requires monthly interest payments, the appropriate compounding assumption is monthly compounding. The loan is not a below-market loan because it requires monthly payments of interest based on a rate of 9.80 percent, the applicable Federal rate of interest based on monthly compounding.

Example (5). (i) A makes a demand loan to her son, B, on April 1, 1985. The loan requires quarterly interest payments due at the end of each calendar quarter at a rate of 10 percent. Assume that on April 1, 1985, the Federal statutory short-term rate in effect is 12 percent, compounded quarterly, and that the alternate Federal short-term rate in effect for the month of April is 10 percent, compounded quarterly. The loan is not a below-market loan for the period April 1, 1985, through June 30, 1985.

(ii) Assume that on July 1, 1985, the Federal statutory short-term rate in effect is 11 percent, compounded quarterly, and the alternate Federal short-term rate in effect for the month of July is 10.20 percent, compounded quarterly. The loan no longer has sufficient stated interest. If A raises the interest rate to at least 10.20 percent, the loan will have sufficient stated interest and will not be a below-market loan for the period of July 1 through December 31, 1985.

(iii) Assume that on July 1, 1985, A increases the interest rate on the loan to 10.20 percent, a rate equal to the alternate Federal short-term rate in effect for July. Further assume that the alternate Federal short-term rate subsequently decreases so that such rate in effect for the month of August decreases to 10 percent. On August 1, 1985, A lowers the interest rate on this loan to 10 percent and does not change that rate for the remainder of the semiannual period. The loan has sufficient stated interest and will not be a below-market loan for the semiannual period beginning on July 1, 1985, even if the alternate Federal rate is greater than 10 lpercent for any or all of the four remaining months in the semiannual period ending on December 31, 1985.

(d) *Short periods.* The rules for determining whether a loan has sufficient stated interest also apply to short periods (*e.g.*, a period that is shorter than the interval between interest payments or interest compounding under the loan which may occur at the beginning or end of the loan). For special computational rules and examples relating to a short periods, see §1.7872-12.

(e) *Variable rates of interest*—(1) *In general.* If a loan requires payments of interest calculated at a rate of interest based in whole or in part on an objective index or combination of indices of market interest rates (*e.g.*, a prime rate, the applicable Federal rate, the average yield on government securities as reflected in the weekly Treasury bill rate, the Treasury constant maturity series, or LIBOR (London interbank offered rate)), the loan will be treated as having sufficient state stated interest if—

(i) In the case of a term loan, the rate fixed by the index or indices is no lower than the applicable Federal rate, as determined under paragraph (b)(4) of this section (as modified by paragraph (e)(2) of this section), on the date the loan in made; or

(ii) In the case of a demand loan, the interest rate fixed by the index or indices is no lower than the applicable Federal rate, as determined under paragraph (b)(3) of this section, for each semiannual period that the loan is outstanding. See paragraph (e)(2)(i) of this section for rules relating to variable interest rate demand loans the interest rates of which are tied to the applicable Federal rate.

(2) *Special rules*—(i) *Demand loans tied to the applicable Federal rate.* A variable rate demand loan will be treated as having sufficient stated interest if, by the terms of the loan agreement, the interest rate cannot be less than the lower of the Federal statutory short-term rate or the alternate Federal short-term rate in effect at the beginning (or, if the agreement so provides, at the end) of the payment or compounding period (whichever is shorter).

(ii) *Applicable Federal rate for variable interest rate term loans.* For purposes of determining the applicable Federal rate, if a term loan requires payments or compounding of interest based on a variable rate (within the meaning of paragraph (e)(1) of this section), the term of the loan shall be treated as being equal to the longest period of time that exists between the dates that, under the loan agreement, the interest rate charged on the loan is required to be recomputed (whether or not the recomputation results in a rate different from the immediately preceding rate). Thus, for example, in the case of a 10 year term loan that charges interest at a variable rate equal to a rate 2 points above the prime rate, and that requires that the interest rate be adjusted every 18 months to reflect any changes in the prime rate, the applicable Federal rate is determined by treating the loan as having a term of 18 months rather than a term of 10 years. Accordingly, the applicable Federal short-term rate rather than the applicable Federal long-term rate shall apply.

(3) The provision of paragraph (e)(1) of this section may be illustrated by the following examples:

Example (1). On April 1, 1985, A loans $200,000 to B, repayable on demand. The note calls for interest to be paid semiannually on September 30 and March 31 of each year at a rate equal to the alternate Federal short-term rate (based on semiannual compounding) for the month in which the payment is made. The loan has sufficient stated interest.

Example (2). Assume the same facts as in *Example (1)* except that the note calls for interest at a rate equal to the lower of the alternate Federal

short-term rate or the statutory Federal short-term rate (in each case, based on semiannual compounding) for the month in which the payment is made. The loan has sufficient stated interest.

Example (3). Assume the same facts as in *Example (1)* except that interest is computed and compounded at the end of each month at a rate equal to the lower of the alternate Federal short-Term rate or the statutory Federal short-term rate (in each case, based on monthly compounding) in effect for that month. Accrued interest is payable semiannually on September 30 and March 31 of each year. The loan has sufficient stated interest.

Example (4). Assume the same facts as in *Example (1)* except that interest is payable at the prime rate of a major lending institution at the time each payment is made. The prime rate is not an index which by its terms cannot be less than the lower of the statutory Federal short-term rate or the alternate Federal short-term rate. Therefore, the loan will be tested for sufficient stated interest in each semiannual period under the rules of paragraph (b)(3) of this section.

(f) *Contingent interest.*

[RESERVED]

§1.7872-4 Types of below-market loans

(a) *In general.* Section 7872 applies only to certain categories of below-market loans. These categories are gift loans, compensation-related loans, corporation-shareholder loans, tax avoidance loans, and certain other loans classified in the regulations under section 7872 as significant tax effect loans (*i.e.*, loans whose interest arrangements have a significant effect on any Federal tax liability of the lender or the borrower.)

(b) *Gift loans*—(1) *In general.* The term "gift loan" means any below-market loan in which the foregoing of interest is in the nature of a gift within the meaning of Chapter 12 of the Internal Revenue Code (whether or not the lender is a natural person).

(2) *Cross reference.* See §1.7872-8 for special rules limiting the application of section 7872 to gift loans. See paragraph (g) of this section for rules with respect to below-market loans which are indirectly gift loans.

(c) *Compensation-related loans*—(1) *In general.* A compensation-related loan is a below-market loan that is made in connection with the performance of services, directly or indirectly, between—

(i) An employer and an employee,

(ii) An independent contractor and a person for whom such independent contractor provides services, or

(iii) A partnership and a partner if the loan is made in consideration for services performed by the partner acting other than in his capacity as a member of the partnership.

The imputed transfer (amount of money treated as transferred) by the lender to the borrower is compensation. For purposes of this section, the term "in connection with the performance of services" has the same meaning as the term has for purposes of section 83. A loan from a qualified pension, profit-sharing, or stock bonus plan to a participant of the plan is not, directly or indirectly, a compensation-related loan.

(2) *Loan in part in exchange for services.* Except as provided in paragraph (d)(2) of this section (relating to a loan from a corporation to an employee who is also a shareholder of the corporation), a loan which is made in part in exchange for services and in part for other reasons is treated as a compensation-related loan for purposes of section 7872(c)(3) only if more than 25 percent of the amount loaned is attributable to the performance of services. If 25 percent or less of the amount loaned is attributable to the performance of services, the loan is not subject to section 7872 by reason of being a compensation-related loan. The loan may, however, be subject to section 7872 by reason of being a below-market loan characterized other than as a compensation-related loan (*e.g.*, corporation-shareholder loan or tax avoidance loan). If—

(i) a loan is characterized as a "compensation-related" loan under this paragraph (c),

(ii) less than 100 percent of the amount loaned is attributable to the performance of services, and

(iii) the portion of the amount loaned that is not attributable to the performance of services is not subject to section 7872, then the amounts of imputed transfer (as defined in §1.7872-1(a)(2)) and imputed interest (as defined in §1.7872-1(a)) are determined only with respect to that part of the loan which is attributable to services. All of the facts and circumstances surrounding the loan agreement and the relationship between the lender and the borrower are taken into account in determining the portion of the loan made in exchange for services.

(3) *Third-party lender as agent.* A below-market loan by an unrelated third-party lender to an employee is treated as attributable to the performance of services if, taking into account all the facts and circumstances, the transaction is in substance a loan by the employer made with the aid of a third-party lender acting as an agent of the employer. Among the facts and circumstances which indicate whether such a loan has been made is whether the employer bears the risk of default at and immediately after the time the loan is made. The principles of this paragraph (c)(3) also apply with respect to a below-market loan by an unrelated third-party lender to an independent contractor.

(4) *Special rule for continuing care facilities.* Any loan to a continuing care facility will not be treated, in whole or in part, as a compensation-related loan.

(5) *Cross-references.* For a special rule in the case of a below-market loan that could be characterized as both a compensation-related loan and a corporation-shareholder loan, see paragraph (d)(2) of this section. See paragraph (g) of this section for rules with respect to below-market loans which are indirectly compensation-related loans.

(d) *Corporation-shareholder loans*—(1) *In general.* A below-market loan is a corporation-shareholder loan if the loan is made directly or indirectly between a corporation and any shareholder of the corporation. The amount of money treated as transferred by the lender to the borrower is a distribution of money (characterized according to section 301 or in the case of an S corporation, section 1368) if the corporation is the lender, or a contribution to capital if the shareholder is the lender.

(2) *Special rule.* A below-market loan—

(i) from a publicly held corporation to an employee of the corporation who is also a shareholder owning directly or indirectly more than 0.5 percent of the total voting power of all classes of stock entitled to vote or more than 0.5 percent of the total value of shares of all other classes of stock or 0.5 percent of the total value of shares of all classes of stock (including voting stock) of the corporation; or

(ii) from a corporation that is not a publicly held corporation to an em-

ployee of the corporation who is also a shareholder owning directly or indirectly more than 5 percent of the total voting power of all classes of stock entitled to vote or more than 5 percent of the total number of shares of all other classes of stock or 5 percent of the total value of shares of all classes of stock (including voting stock) of the corporation; will be presumed to be a corporation-shareholder loan, in the absence of clear and convincing evidence that the loan is made solely in connection with the performance of services. For purposes of determining the percentage of direct and indirect stock ownership, the constructive ownership rules of section 267(c) apply.

(3) *Cross-reference.* See paragraph (g) of this section for rules with respect to below-market loans which are indirectly corporation-shareholder loans.

(e) *Tax avoidance loans.* A tax avoidance loan is any below-market loan one of the principal purposes for the interest arrangements of which is the avoidance of Federal tax with respect to either the borrower or the lender, or both. For purposes of this rule, tax avoidance is a principal purpose of the interest arrangements if a principal factor in the decision to structure the transaction as a below-market loan (rather than, for example, as a market interest rate loan and a payment by the lender to the borrower) is to reduce the Federal tax liability of the borrower or the lender or both. The purpose for entering into the transaction (for example, to a make a gift or to pay compensation) is irrelevant in determining whether a principal purpose of the interest arrangements of the loan is the avoidance of Federal tax.

(f) *Certain below-market loans with significant effect on tax liability ("significant-effect" loans)*—[RESERVED].

(g) *Indirect loans*—(1) *In general.* If a below-market loan is made between two persons and, based on all the facts and circumstances, the effect of the loan is to make a gift or a capital contribution or a distribution of money (under section 301 or in the case of an S corporation, section 1368), or to pay compensation to a third person ("indirect participant"), or is otherwise attributable to the relationship of the lender or borrower to the indirect participant, the loan is restructured as two or more successive below-market loans ("deemed loans") for purposes of section 7872, as follows:

(i) A deemed below-market loan made by the named lender to the indirect participant; and

(ii) A deemed below-market loan made by the indirect participant to the borrower.

Section 7872 is applied separetely to each deemed loan, and each deemed loan is treated as having the same provisions as the original loan between the lender and the borrower. Thus, for example, if a father makes an interest-free loan to his daughter's corporation, the loan is restructured as a below-market loan from father to daughter (deemed gift loan) and a second below-market loan from daughter to corporation (deemed corporation-shareholder loan). Similarly, if a corporation makes an interest-free loan to another commonly controlled corporation, the loan is restructured as a below-market loan from the lending corporation to the common parent corporation and a second below-market loan from the parent corporation to the borrowing corporation.

(2) *Special rule for intermediaries.* If a lender and a borrower use another person, such as an individual, a trust, a partnership, or a corporation, as an intermediary or middleman in a loan transaction and a purpose for such use is to avoid the application of section 7872(c)(1)(A), (B), or (C), the intermediary will be ignored and the loan will be treated as made directly between the lender and the borrower. Thus, for example, if a father and a son arrange their below-market loan transaction by having the father make a below-market loan to the father's partnership, followed by a second below-market loan (with substantially identical terms and conditions as the first loan) made by the partnership to the son, the two below-market loans will be restructured as one below-market loan from the father to the son.

§1.7872-5 Exempted loans.

(a) *In general*—(1) *General rule.* Except as provided in paragraph (a)(2) of this section, notwithstanding any other provision of section 7872 and the regulations thereunder, section 7872 does not apply to the loans listed in paragraph (b) of this section because the interest arrangements do not have a significant effect on the Federal tax liability of the borrower or the lender.

(2) *No exemption for tax avoidance loans.* If a taxpayer structures a transaction to be a loan described in paragraph (b) of this section and one of the principal purposes of so structuring the transaction is the avoidance of Federal tax, then the transaction will be recharacterized as a tax avoidance loan as defined in section 7872(c)(1)(D).

(b) *List of exemptions.* Except as provided in paragraph (a) of this section, the following transactions are exempt from section 7872:

(1) Loans which are made available by the lender to the general public on the same terms and conditions and which are consistent with the lender's customary business practices;

(2) Accounts or withdrawable shares with a bank (as defined in section 581), or an institution to which section 591 applies, or a credit union, made in the ordinary course of its business;

(3) Acquisitions of publicly traded debt obligations for an amount equal to the public trading price at the time of acquisition.

(4) Loans made by a life insurance company (as defined in section 816(a)), in the ordinary course of its business, to an insured, under a loan right contained in a life insurance policy and in which the cash surrender values are used as collateral for the loans;

(5) Loans subsidized by the Federal, State (including the District of Columbia), or Municipal government (or any agency or instrumentality thereof), and which are made available under a program of general application to the public;

(6) Employee-relocation loans that meet the requirements of paragraph (c)(1) of this section;

(7) Obligations the interest on which is excluded from gross income under section 103;

(8) Obligations of the United States government;

(9) Loans to a charitable organization (described in section 170(c)), but only if at no time during the taxable year will the aggregate outstanding amount of loans by the lender to all such organizations exceed $10,000;

(10) Loans made to or from a foreign person that meet the requirements of

paragraph (c)(2) of this section;

(11) Loans made by a private foundation or other organization described in section 170(c), the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B);

(12) Loans made prior to July 1, 1986, to the extent excepted from the application of section 482 for the 6-month (or longer) period referred to in §1.482-2 (a)(3);

(13) for periods prior to July 1, 1986, all money, securities, and property received by a futures commission merchant or by a clearing organization (i) to margin, guarantee or secure contracts for future delivery on or subject to the rules of a qualified board or exchange (as defined in section 1256(g)(7)), or (ii) to purchase, margin, guarantee or secure options contracts traded on or subject to the rules of a qualified board or exchange, and all money accruing to account holders as the result of such futures and options contracts;

(14) Loans where the taxpayer can show that the below market interest arrangements have no significant effect on any Federal tax liability of the lender or the borrower, as described in paragraph (c)(3) of this section; and

(15) Loans, described in revenue rulings or revenue procedures issued under section 7872(g)(1)(C), if the Commissioner finds that the factors justifying an exemption for such loans are sufficiently similar to the factors justifying the exemptions contained in this section.

(c) *Special rules*—(1) *Employee-relocation loans*—(i) *Mortgage loans.* In the case of a compensation-related loan to an employee, where such loan is secured by a mortagage on the new principal residence (within the meaning of section 217 and the regulations thereunder) of the employee, acquired in connection with the transfer of that employee to a new principal place of work (which meets the requirements in section 217(c) and the regulations thereunder), the loan will be exempt from section 7872 if the following conditions are satisfied:

(A) The loan is a demand loan or is a term loan the benefits of the interest arrangements of which are not transferable by the employee and are conditioned on the future performance of substantial services by the employee;

(B) The employee certifies to the employer that the employee reasonably expects to be entitled to and will itemize deductions for each year the loan is outstanding; and

(C) The loan agreement requires that the loan proceeds be used only to purchase the new principal residence of the employee.

(ii) *Bridge loans.* If the case of a compensation-related loan to an employee which is not described in paragraph (c)(1)(i) of this section, and which is used to purchase a new principal residence (within the meaning of section 217 and the regulations thereunder) of the employee acquired in connection with the transfer of that employee to a new principal place of work (which meets the requirements in section 217(c) and the regulations thereunder), the loan will be exempt from section 7872 if the following conditions are satisfied:

(A) The conditions contained in paragraphs (c)(1)(i)(A), (B), and (C) of this section;

(B) The loan agreement provides that the loan is payable in full within 15 days after the date of the sale of the employee's immediately former principal residence;

(C) The aggregate principal amount of all outstanding loans described in this paragraph (c)(1)(ii) to an employee is no greater than the employer's reasonable estimate of the amount of the equity of the employee and the employee's spouse in the employee's immediately former principal residence, and

(D) The employee's immediately former principal residence is not converted to business or investment use.

(2) *Below-market loans involving foreign persons*—(i) Section 7872 shall not apply to a below-market loan (other than a compensation-related loan or a corporation-shareholder loan where the borrower is a shareholder that is not a C corporation as defined in section 1361(a)(2)) if the lender is a foreign person and the borrower is a U.S. person, unless the interest income imputed to the foreign lender (without regard to this paragraph) would be effectively connected with the conduct of a U.S. trade or business within the meaning of section 864(c) and the regulations thereunder and not exempt from U.S. income taxation under an applicable income tax treaty.

(ii) Section 7872 shall not apply to a below-market loan where both the lender and the borrower are foreign persons unless the interest income imputed to the lender (without regard to this paragraph) would be effectively connected with the conduct of a U.S. trade or business within the meaning of section 864(c) and the regulations thereunder and not exempt from U.S. income taxation under an applicable income tax treaty.

(iii) For purposes of this section, the term "foreign person" means any person that is not a U.S. person.

(3) *Loans without significant tax effect.* Whether a loan will be considered to be a loan the interest arrangements of which have a significant effect on any Federal tax liability of the lender or the borrower will be determined according to all of the facts and circumstances. Among the factors to be considered are—

(i) whether items of income and deduction generated by the loan offset each other;

(ii) the amount of such items;

(iii) the cost to the taxpayer of complying with the provisions of section 7872 if such section were applied, and

(iv) any non-tax reasons for deciding to structure the transaction as a below-market loan rather than a loan with interest at a rate equal to or greater than the applicable Federal rate and a payment by the lender to the borrower.

§1.7872-6 Timing and amount of transfers in connection with gift loans and demand loans

(a) *In general.* Section 7872(a) and the provisions of this section govern the timing and the amount of the imputed transfer by the lender to the borrower and the imputed interest payment by the borrower to the lender in the case of a below-market demand loan. Section 7872(a) and this section also govern the timing and the amount of the imputed transfer by the lender to the borrower and the imputed interest payment by the borrower to the lender for income tax purposes in the case of term gift loans. (See section 7872(b), 7872(d)(2), and §1.7872-7 for rules governing the timing and the amount of

the imputed transfer by the lender to the borrower in the case of term gift loans for gift tax puirposes.) Section 7872 (d)(1) and §1.7872-8 limit the amount of the imputed interest payment with respect to certain gift loans. See §1.7872-10(a) for rules for distinguishing demand loans from term loans. See 1.7872-11(f) for special rules governing loans repayable in foreign curency, which apply notwithstanding any contrary rules set forth in this section.

(b) *Time of transfer*—(1) *In general.* Except as otherwise provided in paragraphs (b)(3), (4), and (5) of this section, the foregone interest (as defined in section 7872(e)(2) and paragraph (c) of this section) attributable to periods during any calendar year iis treated as trasferred by the lender to the borrower (and retransfered by the borrower to the lender) on December 31 of that calendar year and shall be treated for tax purposes in a manner consistent with the taxpayer's method of accounting.

(2) *Example.* Paragraph (b)(1) of this section may be illustrated by the following example.

Example. On January 1, 1985, E makes a $200,000 interest-free demand loan to F, an employee of E. The loan remains outstanding for the entire 1985 calendar year. E has a taxable year ending September 30. F is a calendar year taxpayer. For 1985, the imputed compensation payment and the imputed interest payment (as computed under paragraph (c) of this section) are treated as made on December 31.

(3) *Gift loans between natural persons.* In the case of gift loans directly between natural persons within the meaning of §1.7872-8(a)(2), any imputed transfer and any imputed interest payment to which this section applies during the borrower's taxable year is treated, for both the lender and the borrower, as occurring on the last day of the borrower's taxable year.

(4) *Death, liquidation or termination of borrower.* If the borrower dies (in the case of a borrower who is a natural person) or is liquidated or otherwise terminated (in the case of a borrower other than a natural person) any imputed transfer and any imputed interest payment arising during the borrower's final taxable year are treated, for both the lender and the borrower as occurring on the last day of the borrower's final taxable year.

(5) *Repayment of loan.* If a below-market loan is repaid, any imputed transfer and any imputed interest payment arising during the borrower's taxable year which includes the date of repayment is treated, for both the lender and the borrower, as occurring on the day the loan is repaid.

(c) *Amount of transfer* In the case of a below-market loan to which section 7872 applies and which is a demand loan (including a term loan that is treated as a demand loan as provided in section §1.7872-10(a)(5)) or a gift term loan, the foregone interest (as computed under the provisions of §1.7872-13) with respect to the loan is treated as transferred by the lender to the borrower and retransferred as interest by the borrower to the lender. Generally, for any calendar year the term "foregone interest" means the excess of—

(1) The amount of interest that would have been payable in that year if interest had accrued at the applicable Federal rate (as determined in §1.7872-13); over

(2) Any interest payable on the loan properly allocable to that year.

The amount of foregone interest is computed for each day during the period for which section 7872(a) applies to the loan and is treated as transferred and retransferred on the date specified in paragraph (b) of this section.

§1.7872-7 Timing and amount of transfers in connection with below-market term loans.

(a) *In General.* This section governs the Federal income tax consequences of below-market term loans, other than gift term loans or term loans treated as demand loans under the provisions of §1.7872-10(a)(5), to which section 7872 applies. It also governs the Federal gift tax consequences of below-market gift term loans. See §1.7872-11(f) for special rules which govern loans repayable in foreign currency and which apply notwithstanding any contrary rules set forth in this section.

(1) *Timing and amount of transfer from lender to borrower.* In the case of term loans to which this section applies, the amount of the imputed transfer by the lender to the borrower—

(i) is treated as transferred at the time the loan is made and is treated for tax purposes in a manner consistent with the taxpayer's method of accounting; and

(ii) Is equal to the excess of—

(A) The amount loaned (as defined in paragraph (a)(4) of this section); over

(B) The present value (as determined in paragraph (a)(5) of this section and §1.7872-14) of all payments which are required to be made under the terms of the loan agreement, whether express or implied.

(2) *Gift term loans.* In the case of a gift term loan, the rules of paragraph (a)(1) of this section apply for gift tax purposes only. For rules governing the income tax consequences of gift term loans, see §1.7872-6.

(3) *Treatment of amount equal to imputed transfer as original issue discount*—(i) *In general.* Any below-market loan to which paragraph (a)(1) of this section applies shall be treated as having original issue discount in an amount equal to the amount of the imputed transfer determined under paragraph (a)(1) of this section. This imputed original issue discount is in addition to any other original issue discount on the loan (determined without regard to section 7872(b) or this paragraph). For purposes of applying section 1272 to a loan described in this paragraph, the issue price shall be treated as equal to the stated principal reduced by the amount of the imputed transfer and the yield to maturity is the applicable Federal rate.

(ii) *Example.* The provisions of this paragraph (a)(3) may be illustrated by the following example.

Example. (i) On June 10, 1984, L lends $45,000 to B, a corporation in which L is a shareholder, for five years in exchange for a $50,000 note bearing interest at a below-market rate. Assume that the present value of all payments that B must make to L is $42,000. This loan is a corporation-shareholder term loan under section 7872(c)(1)(C). Accordingly, the amount of the imputed transfer by L to B is determined under the provisions of section 7872(b).

(ii) On June 10, 1984, L is treated as transferring $3,000 (the excess of $45,000 (amount loaned) over $42,000 (present value of all payments)), in accordance with section 7872(b)(1). This imputed transfer is treated as a contribution to B's capital by L. An amount equal to the imputed transfer is treated as original issue discount. This original issue discount is in addition to the $5,000 ($50,000, the stated redemption price, less $45,000, the issue price) of original issue discount othewise determined under

section 1273. As a result, the loan is treated as having a total of $8,000 of original issue discount.

(4) *Amount loaned.* The term "amount loaned" means the amount received by the borrower (determined without regard to section 7872). See §1.7872-2(a)(3) for the treatment of the transfer of the loan proceeds to the borrower in installments or subject to draw-down restrictions.

(5) *Present value.* The present value of all payments which are required to be made under the provisions of the loan agreement is computed as of the date the loan is made (or, if later, as of the day the loan first becomes subject to the provisions of section 7872). The discount rate for the present value computation is the applicable Federal rate as defined in §1.7872-3(b) in effect on the day on which the loan is made. For rules governing the computation of present value, see §1.7872-14. See also *Example (3)* in §1.7872-8(b)(5).

(6) *Basis.* In the case of a term loan the lender's basis in the note received in exchange for lending money is equal to the present value of all payments which are required to be made under the terms of the loan agreement, whether express or implied, with adjustments as provided for in section 1272(d)(2).

(b) *Special rule for the de minimis provisions*—(1) *In general.* If as a result of the application of the *de minimis* provisions of section 7872(c)(2) or (3), a loan becomes subject to section 7872 and this section on a day after the day on which the loan is made, the provisions of this section generally apply to the loan as if the loan were made on that later day. The applicable Federal rate applied to this loan (including for purposes of computing the present value of the loan), however, is the applicable Federal rate (as defined in §1.7872-3(b)) in effect on the day on which the loan is first made. The present value computation described in paragraph (a)(1)(ii)(B) of this section is made as of the day on which section 7872 and this section first apply to the loan. For purposes of making this computation, the term of the loan is equal to the period beginning on the day that section 7872 first applies to the loan and ending on the day on which the loan is to be repaid according to the loan agreement. Any payments payable according to the loan agreement before the day on which section 7872 and this section first apply to the loans are disregarded.

(2) *Continuing application of section 7872.* Once section 7872 and this section apply to a term loan, they continue to apply to the loan regardless of whether the *de minimis* provisions of section 7872(c)(2) or (3) apply at some later date. In the case of a gift term loan, this paragraph applies only for gift tax purposes and does not apply for income tax purposes.

§1.7872-8 Special rules for gift loans directly between natural persons

(a) *Special rules for gift loans directly between natural persons*—(1) *In general.* Section 7872(c)(2) and (d) apply special rules to gift loans directly between natural persons if the aggregate outstanding amount of loans (as determined in paragraph (b)(2) of this section) between those natural persons does not exceed specified limitations.

(2) *Loans directly between natural persons*—(i) For purposes of this section, a loan is made directly between natural persons only if both the lender and borrower are natural persons. For this purpose, a loan by a natural person lender to the guardian (or custodian, in the case of a gift made pursuant to the Uniform Gift to Minors Act) of a natural person is treated as a loan directly between natural persons. If, however, a parent lends money to a trust of which the child is the sole beneficiary, the loan is not treated as directly between natural persons for purposes of this section.

(ii) A gift loan which results from restructuring an indirect loan as two or more loans (as described in §1.7872-4(g)) and in which natural persons are deemed to be the lender and the borrower is treated as a loan directly between natural persons. Thus, for example, if an employer makes a below-market loan to an employee's child, the loan is restructured as one loan from the employer to the employee, and a second loan from the employee to his child. The deemed gift loan between the employee and the employee's child is treated as directly between natural persons.

(b) *De minimis exception*—(1) *In general.* Except as otherwise provided in paragraph (b)(3) of this section or in §1.7872-7(a) (with respect to the gift tax consequences of a gift term loan to which the provisions of section 7872 have already been applied), in the case of any gift loan directly between natural persons, the provisions of section 7872 do not apply to any loan outstanding on any day on which the aggregate outstanding amount of loans between the lender and borrower does not exceed $10,000. The *de minimis* rule of this paragraph (b)(1) applies with respect to a gift loan even though that loan could also be characterized as a tax avoidance loan within the meaning of section 7872(c)(1)(D) and §1.7872-4(e).

(2) *Aggregate outstanding amount of loans.* The aggregate outstanding amount of loans between natural persons is the sum of the principal amounts of outstanding loans directly between the individuals, regardless of the character of the loans, regardless of the interest rate charged on the loans, and regardless of the date on which the loans were made. For this purpose, the principal amount of a loan which is also subject to section 1272 (without applying the limitation of section 1273(a)(3)) is the "adjusted issue price" as that term is defined in section 1272(a)(4). See §1.7872-7(a)(3)(i) for the determination of the issue price of a loan which is also subject to section 1272.

(3) *Loans attributable to acquisition or carrying of income-producing assets.* The *de minimis* exception described in paragraph (b)(1) of this section does not apply to any gift loan directly attributable to the purchase or carrying of income-producing assets. A gift loan is directly attributable to the purchase or carrying of income-producing assets, for example, if the loan proceeds are directly traceable to the purchase of the income-producing assets, the assets are used as collateral for the loan, or there is direct evidence that the loan was made to avoid disposition of the assets.

(4) *Income-producing assets.* For purposes of this paragraph 9b), the term "income-producing asset" means (i) an asset of a type that generates ordinary income, or, (ii) a market discount bond issued before July 19,

1984. Accordingly, an income producing asset includes, but is not limited to, a business, a certificate of deposit, a savings account, stock (whether or not dividends are paid), bonds and rental property.

(5) *Examples.* The provisions of this paragraph (b) may be illustrated by the following examples.

Example (1). (i) As of January 1, 1985, the total aggregate outstanding amount of loans by Parent P, to child, C, is $6,000. None of these loans is a below-market loan. On February 1, 1985, P makes a $3,000 below-market demand loan to C. On March 1, 1985, P makes a $2,000 below-market demand loan to C. On November 1, 1985, C repays $1,500 of principal of the market-rate loans to P; all of the other loans remain outstanding as of December 31, 1985. The below-market loans are gift loans and are the only new loans between P and C for calendar year 1985.

(ii) For the periods January 1, 1985, through February 28, 1985, and November 1, 1985, through December 31, 1985, section 7872 does not apply to the loans between P and C because the outstanding loan balance between P and C does not exceed $10,000 during these periods. For the period beginning on March 1, 1985, and ending on October 31, 1985, however, the aggregate outstanding amount of loans directly between P and C exceeds $10,000. Accordingly, the provisions of section 7872(a) apply to the $3,000 gift loan and $2,000 gift loan during that period.

Example (2). (i) Assume the same facts as in Example (1) except that the $2,000 gift loan made on March 1, 1985, is a term loan for a period of five years. The Federal gift tax and income tax consequences of the $3,000 gift demand loan made on February 1, 1985, are the same as in Example (1).

(ii) With respect to the $2,000 gift term loan, section 7872(b)(1) applies beginning on March 1, 1985, for purposes of computing the amount of the imputed gift by P to C. For the period beginning on March 1, 1985, and ending on October 31, 1985, section 7872(a) applies to the $2,000 gift term loan for purposes of determining the amount and the timing of the imputed interest payment by C to P. For the two-month period beginning on November 1, 1985, section 7872(a) does not apply to the $2,000 loan for Federal income tax purposes because the outstanding loan balance between P and C does not exceed $10,000 during this period.

Example (3). (i) Assume the same facts as in Example (1) except that the $3,000 gift loan made on February 1, 1985, is a term loan for a period of five years. The Federal gift tax and income tax consequences of the $2,000 demand gift loan made on March 1, 1985, are identical to those in Example (1).

(ii) On February 1, 1985, section 7872 does not apply to the $3,000 loan because the outstanding loan balance between P and C does not exceed $10,000. On March 1, 1985, however, the aggregate outstanding amount of loans between P and C exceeds $10,000. For Federal gift tax purposes, § 7872(b)(1) applies to the $3,000 loan beginning on March 1, 1985. Under §1.7872-7(b), the provisions of section 7872 apply to the $3,000 loan for gift and income tax purposes as if the loan had been made on March 1, 1985. See §1.7872-7(a)(5) for special rules for computing the present value of payments due on the loan. For the eight-month period beginning on March 1, 1985, section 7872(a) applies to the $3,000 loan for purposes of determining the imputed interest payment by C to P. For the two-month period beginning on November 1, 1985, section 7872(a) does not apply to the $3,000 loan for Federal income tax purposes because of the application of the *de minimis* provisions.

Example (4). On June 10, 1984, parent, L, makes an $8,000 interest-free gift term loan to L's child, B. This is the only loan outstanding between L and B during 1984. On June 11, 1984, B invests the $8,000 in corporate stock. The $10,000 *de minimis* provision does not apply to the loan, because the loan proceeds are directly attributable to the purchase of corporate stock, an income-producing asset.

(c) *Limitation on amount of imputed interest payment*—(1) *In general.* In the case of a loan between a borrower and a lender both of whom are natural persons (within the meaning of paragraph (a)(2) of this section), for all days during the borrower's taxable year on which the aggregate outstanding amount of loans (within the meaning of paragraph (b)(2) of this section) between the borrower and the lender, is $100,000 or less, the amount of the imputed interest payment by the borrower to the lender with respect to any gift loan is limited to the borrower's net investment income (as determined under paragraph (c)(7) of this section) for the taxable year. This paragraph (c) does not affect the gift tax consequences of any loan under section 7872.

(2) *Tax avoidance loan.* Paragraph (c)(1) of this section does not apply to any loan which is a tax avoidance loan within the meaning of §1.7872-4(e).

(3) *No limitation if investment income is manipulated.* Paragraph (c)(1) of this section does not apply if a borrower can control the timing of the receipt of investment income and actually does manipulate the timing to accelerate or defer the receipt of investment income. For example, if the borrower can, and actually does, control the timing of dividends paid by a closely held corporation, the limitation on the amount of the imputed interest payment does not apply.

(4) *Net investment income of $1,000 or less disregarded.* If paragraph (c)(1) of this section applies and if the borrower's net investment income (as determined under paragraph (c)(7) of this section) for a taxable year is $1,000 or less, the borrower's net investment income for that year is deemed to be zero for purposes of this paragraph (c).

(5) *No proration of net investment income.* The entire amount of the borrower's net investment income for a taxable year (as determined under paragraph (c)(7) of this section) is taken into account in determining the maximum imputed interest payment for those days during the year on which the net investment income limitation applies. Accordingly, the amount of net investment income is not allocated among the days of the borrower's taxable year. Further, for a taxable year of a borrower which ends after June 6, 1984, and includes any day or days before June 7, 1984, the entire amount of net investment income for the taxable year is taken into account in determining the maximum imputed interest payment for the days during that year on which the limitation applies.

(6) *Allocation among gift loans.* In the case of a borrower who has more than one gift loan outstanding during a taxable year, the borrower's net investment income for that year is allocated among the gift loans in proportion to the respective amounts which would be treated as imputed interest payments by the borrower to the lender or lenders with respect to those loans without regard to this paragraph (c). (See Example (2) of paragraph (c)(9) of this section.) No amount of the net investment income is allocable to any gift loan between the lender and the borrower for periods during which the aggregate outstanding amount of loans (within the meaning of paragraph (b)(2) of this section) between the borrower and that lender exceeds $100,000.

(7) *Amounts included in net investment income.* For purposes of section 7872, net investment income for a taxable year equals the sum of—

(i) Net investment income for that year as determined under section 163(d)(3), excluding any item of income on a deferred payment obligation which is treated under section 7872(d)(1)(E)(iii) and paragraph (c)(7)(ii) of this section as interest received in a prior taxable year ending after June 6, 1984, and

(ii) The amount that is treated under

section 7872(d)(1)(E)(iii) as interest received for that year on a deferred payment obligation.

(8) *Deferred payment obligation.* The term "deferred payment obligation" means a market discount bond issued before July 18, 1984, or an obligation that, if held to maturity, would produce a predictable and regular flow of ordinary income which, under applicable tax rules, is not recognized until a subsequent period. Accordingly, deferred payment obligations include, but are not limited to, those obligations listed in section 7872(d)(1)(E)(iv).

(9) *Examples.* The provisions of this paragraph (c) may be illustrated by the following examples.

Example (1). On January 1, 1985, parent P makes a $50,000 below-market gift loan to C, P's child, who uses the calendar year as the taxable year. On March 1, 1985, P makes an additional $75,000 market-rate loan to C. On October 1, 1985, C repays $30,000 of the market-rate loan. Assume that C's net investment income (as determined under paragraph (c)(7) of this section) for 1984 is $2,400. The limitation under section 7872(d)(1) on the amount of imputed interest payment applies to the $50,000 loan for the two-month period beginning on January 1, 1985, and the three-month period beginning on October 1, 1985. ACcordingly, the imputed interest payment on the $50,000 loan for 1985 may not exceed $2,400.

Example (2). During 1985, natural person borrower B has three gift loans outstanding, each from a different lender. Each loan is eligible for the entire year for the special limitation on the amount of imputed interest payments under section 7872(d)(1) but none of the loans is eligible for the de minimis exception of paragraph (b) of this section. B's net investment income for 1985 is $6,000. The aggregate imputed interest payments on these loans (determined without regard to section 7872(d)(1)) would be $9,000. The amount of imputed interest payment attributable to each loan after application of section 7872(d)(1) is computed as follows:

Loan	Imputed interest payments (before application of section 7872(d)(1)		Relative share of net investment income (imputed interest payment after application of section 7872(d)(1))
1	$3,000	$2,000	($6,000 × $3,000/$9,000)
2	4,000	2,667	(6,000 × 4,000/ 9,000)
3	2,000	1,333	(6,000 × 2,000/ 9,000)
Total	$9,000	$6,000	

Consequently, the imputed interest payment to lender 1 cannot exceed $2,000; the imputed interest payment to lender 2 cannot exceed $2,667; and, the imputed interest payment to lender 3 cannot exceed $1,333.

§12.7872-9 *De minimis* exception for compensation-related or corporation-shareholder loans.

(a) *In general.* In the case of any demand loan described in section 7872(c)(1)(B) or (C), the provisions of section 7872 do not apply to any day on which the aggregate outstanding amount of loans between the lender and the borrower does not exceed $10,000. In the case of any term loan described in section 7872(c)(1)(B) or (C) (relating to the *de minimis* rules), the provisions of section 7872 apply to the loan as of the first day on which the aggregate outstanding amount of loans between the lender and the borrower exceeds $10,000. Once section 7872 applies to a term loan, section 7872 continues to apply to the loan regardless of whether the $10,000 limitation applies at some later date.

(b) *Aggregate outstanding amount of loans.* The aggregate outstanding amount of loans between the lender and the borrower is the sum of the principal amounts of outstanding loans directly between the parties, regardless of the character of the loans, regardless of the interest rate charged on the loans, and regardless of the date on which the loans were made. For this purpose, the principal amount of a loan which is also subject to section 1272 (without applying the limitation of section 1273(a)(3)) is the "adjusted issue price" as that term is defined in section 12272(a)(4). See §1.7872-7(a)(3)(i) for the determination of the issue price of a loan which is also subject to section 7872.

(c) *Tax avoidance loan.* This section does not apply to any loan which is a tax avoidance loan within the meaning of §1.7872-4(e).

(d) *Example.* The provisions of this section may be illustrated by the following example:

Example. (i) On January 1, 1985, L made a $4,000 four-year term loan to B, a corporation in which L is a shareholder. On October 15, 1986, L made a $7,000 five-year term loan to B. Both loans are interest-free and are payable on the last day of the loan term. There are no other outstanding loans between L and B. Neither loan is a tax avoidance loan.

(ii) For the period beginning on January 1, 1985 and ending on October 14, 1986, the provisions of section 7872 do not apply to the $4,000 loan because the outstanding loan balance between L and B does not exceed $10,000. On October 15, 1986, however, the aggregate amount of loans between L and B exceeds $10,000. Accordingly, the provisions of section 7872(b) apply to both loans. See §1.7872-4(d) for the proper Federal tax treatment of the imputed transfer by L to B. For purposes of computing the present value of all payments to be made under the loan agreements, the applicable Federal rate for the $4,000 loan is the applicable Federal rate in effect on January 1, 1985, for loans with a term of 4 years, (even though less than three years remain before the loan ends). Under §1.7872-7(b), the present value of the payment to be made under the $4,000 loan agreement is determined as of October 15, 1986 (the date on which section 7872 first applies to the $4,000 loan) for a loan with a term which begins on October 15, 1986, and ends on January 1, 1989.

§1.7872-10 Other definitions.

(a) *"Term" and "demand" loans distinguished.* For purposes of section 7872—

(1) *Demand loan.* Any loan which is payable in full at any time on the demand of the lender (or within a reasonable time after the lender's demand), is a "demand loan."

(2) *Term loan.* A loan is treated as a "term loan" if the loan agreement specifies an ascertainable period of time during which the loan is to be outstanding. For purposes of this rule, a period of time is treated as being ascertainable if the period may be determined actuarially. Thus, a loan agreement which provides that D loans E $16,000 for E's life, will be treated as a term loan because the life expectancy of E may be determined actuarially.

(3) *Acceleration and extension clauses.* Acceleration clauses and similar provisions that would make a loan due before the time otherwise specified including provisions permitting prepayment of a loan or accelerating the maturity date on disposition of collateral ("due on sale" clauses) are disregarded for purposes of section 7872. Thus, a loan for a term of 15 years is a term loan for 15 years even if it is subject to acceleration upon some action of the borrower. If the loan agreement specifies an ascertainable period of time during which the loan is to be outstanding but contains an extension clause or

similar provision that would make the loan due after the time otherwise specified, the loan is a term loan during the ascertainable period and a second demand or term loan thereafter; the classification of the second loan as term or demand depends upon the terms of the extension clause.

(4) *Loans for a period of time not ascertainable.* [Reserved]

(5) *Certain loans conditioned on future services.* For all purposes of section 7872 other than determining the applicable Federal rate (see, §1.7872-3(b)), if the benefits of the interest arrangements of a term loan are not transferable by the individual borrower and are conditioned on the future performance of substantial services by the individual borrower (within the meaning of section 83), the loan is treated as a demand loan. All facts and circumstances must be examined to determine whether the future services to be performed are substantial.

(6) *Revolving credit loans.* For purposes of section 7872, an extension of credit by reason of the use of a credit card that is available to a broad segment of the general public is treated as a demand loan, and the provisions of section 7872 may apply if the loan is described in one of the categories set forth in §1.7872-4. The period during which the loan is outstanding begins on the first day on which a finance charge would be assessed if payment of the outstanding balance is not made. For rules governing the computation of foregone interest for demand loans with variable balances, see §1.7872-13(c).

(b) [Reserved for further definitions as needed]

§1.7872-11 Special rules

(a) *Waiver, cancellation or forgiveness of interest payments.* If a loan is made requiring the payment of stated interest and the accrued but unpaid interest is subsequently waived, cancelled, or forgiven by the lender, such waiver, cancellation, or forgiveness is treated as if the interest had in fact been paid to the lender and then retransferred by the lender to the borrower but only if—

(1) the loan initially would have been subject to section 7872 had it been made without interest;

(2) the waiver, cancellation or forgiveness does not include in substantial part the loan principal; and

(3) a principal purpose of the waiver, cancellation, or forgiveness is to confer a benefit on the borrower, such as to pay compensation or make a gift, a capital contribution, a distribution of money under section 301, or a similar payment to the borrower.

The retransferred amount is characterized for Federal tax purposes in accordance with the substance of the transaction. The requisite purpose described in paragraph (a)(iii) of this section is presumed in the case of loans between family members, corporations and shareholders, employers and employees, or an independent contractor and a person for whom such independent contractor provides services unless the taxpayer can show by clear and convincing evidence that the interest obligation was waived, cancelled, or forgiven for a legitimate business purpose of the lender who is acting in the capacity as a creditor seeking to maximize satisfaction of a claim, such as in the case of a borrower's insolvency.

(b) *Disposition of interest or obligation in loan.* [RESERVED]

(c) *Husband and wife treated as 1 person.* Section 7872(f)(7) provides that a husband and wife shall be treated as 1 person. Accordingly, all loans to or from the husband will be combined with all loans to or from the wife for purposes of applying section 7872. All loans between a husband and a wife are disregarded for purposes of section 7872.

(d) *Withholding.* In the case of any loan (term or demand) subject to section 7872, no amount is required to be withheld under chapter 24, relating to the collection of income tax at the source on wages and back-up withholding, with respect to any amount treated as transferred or retransferred under section 7872(a) or (b). Withholding is required where appropriate, however, for purposes of chapter 21, relating to the Federal Insurance Contributions Act, and chapter 22, relating to the Railroad Retirement Tax Act, on any amount of money treated as transferred and retransferred between the lender and borrower because of the application of section 7872.

(e) *Treatment of renegotiations.* [RESERVED]

(f) *Loans denominated in foreign currencies*—(1) *Applicable rate.* If a loan is denominated in a currency other than the U.S. dollar, then for purposes of section 7872 and the regulations thereunder, a rate that constitutes a market interest rate in the currency in which the loan is denominated shall be substituted for the applicable Federal rate.

(2) *Treatment of imputed transfer as interest*—(i) *In general.* If a loan is denominated in a currency other than the U.S. dollar then, notwithstanding section 7872(a)(1)(B), §1.7872-6, and §1.7872-7, the amount of imputed interest treated as retransferred by the borrower to the lender shall only be treated as interest to the extent consistent with other principles of tax law regarding foreign currency lending transactions and to the extent provided in this paragraph (f)(2).

(ii) *Loans denominated in appreciating currencies.* [Reserved]

(iii) *Loans denominated in depreciating currencies.* [Reserved]

(3) *Example.* The provisions of this paragraph (f)(1) may be illustrated by the following example.

Example. A lends her daughter B the sum of 100,000 foreign currency units, repayable in 5 years with interest payable semiannually at a rate of 12 percent. Assume that the market rate of interest for loans denominated in that foreign currency at the time of the transaction is 30 percent, computed semiannually, and that the current exchange rate is 5 foreign currency units to the dollar. A has made a below-market gift loan to B. The amount of A's gift to B is the excess of 100,000 foreign currency units (or $20,000) over the present value of all payments to be made under the loan, using a discount rate of 30 percent, which is 54,831 foreign units (or $10,966). Thus, the amount of A's gift is $9,034.

(g) *Reporting requirements*—(1) *Lender.* A lender must attach a statement to the lender's income tax return for any taxable year in which the lender either has interest imputed under section 7872 or claims a deduction for an amount deemed to be transferred to a borrower under section 7872. The statement must—

(i) Explain that it relates to an amount includible in income or deductible by reason of section 7872,

(ii) Provide the name, address, and taxpayer identification number of each borrower,

(iii) Specify the amount of imputed interest income and the amount and character of any item deductible by rea-

son of section 7872 attributable to each borrower,

(iv) Specify the mathematical assumptions used (*e.g.*, 360 day calendar year, the exact method or the approximate method for computing interest for a short period (see, §1.7872-13)) for computing the amounts imputed under section 7872, and

(v) Include any other information required by the return or the instructions thereto.

(2) *Borrower.* A borrower must attach a statement to the borrower's income tax return for any taxable year in which the borrower either has income from an imputed transfer under section 7872 or claims a deduction for an amount of interest expense imputed under section 7872. The statement must—

(i) Explain that it relates to an amount includible in income or deductible by reason of section 7872,

(ii) Provide the name, address, and taxpayer identification number of each lender,

(iii) Specify the amount of imputed interest expense and the amount of character of any income inputed under section 7872 attributable to each lender,

(iv) Specify the mathematical assumptions used (*e.g.*, 360 day calendar year, the exact method or the approximate method for computing interest for a short period (see, §1.7872–13)) for computing the amounts imputed under section 7872, and

(v) Include any other information required by the return or the instructions thereto.

(3) *Special rule for gift loans.* In the case of a gift loan directly between natural persons, the lender must recognize the entire amount of interest income inputed under section 7872 (determined without regard to section 7872(d)(1)) unless the borrower notifies the lender, in a signed statement, of the amount of the borrower's net investment income properly allocable to the loan according to the provisions of section 7872(d)(1) and §1.7872-8(c)(6).

(4) *Information and reporting.* All amounts inputed under section 7872 (*e.g.*, interest, compensation, gift) are characterized in accordance with the substance of the transaction and, except as otherwise provided in the regulations under section 7872, are treated as so characterized for all purposes of the Code. Accordingly, all applicable information and reporting requirements (*e.g.*, reporting on Form W-2 and Form 1099) must be satisfied.

§1.7872-12 Computational rules to determine sufficient stated interest for short periods.

(a) *Scope.* This section provides computational rules only for the purpose of determining whether the interest payable on a loan during a short period is sufficient to prevent characterization of a loan as a below-market loan under §1.7872-3. For rules for the calculation of the amount of interest to be imputed on a below-market loan, including rules for short periods, see §1.7872-13 and §1.7872-14.

(b) *Short period defined*—(1) *In general.* A short period (as referred to in §1.7872-3(d)) for a loan is any period shorter than the regular compounding period or regular payment interval required under the loan agreement. Generally, a short period will arise at the beginning or the end of a loan (or at the time the loan first become subject to section 7872 because of the application of the *de minimis* provisions). For example, a loan made on January 17, 1985, and calling for semiannual payments of interest on June 30 and December 31 of each year will have a short period beginning on January 17, 1985, and ending on June 30, 1985.

(2) *Special short periods in the case of demand loans.* In the case of a demand loan, in addition to any short periods described in paragraph (b)(1) of this section, additional short periods may also arise because of the need to adjust the applicable Federal rate on January 1 and July 1 of each year. This short periods arise in cases when the dates January 1 or July 1 fall within the compounding periods or payment intervals required under the loan agreement. For example, a below market demand loan made on April 1, 1985, that is outstanding throughout 1985 and that calls for semiannual interest payments on September 30 and March 31 of each year will have 3 short periods in 1985. The first short period begins on April 1, 1985, and ends on June 30, 1985. The second short period begins on July 1, 1985, and ends on September 30, 1985. The third short period begins on October 1, 1985, and ends on December 31, 1985.

(c) *Interest payable for a short period*—(1) *Exact method.* The smallest amount of interest that must be paid for a short period in order to prevent the loan from being a below-market loan is determined by the exact method. The exact method assumes daily compounding of interest.

(2) *Approximate method.* The approximate method is also provided for the convenience of taxpayers who do not wish to use the exact method. The approximate method assumes simple interest within any compounding period and will always produce an amount of interest for the short period that is slightly higher than that produced under the exact method. Under this method, a sufficient amount of interest for any short period is determined by multiplying the amount that would constitute sufficient stated interest for a full period for a fraction the numerator of which is equal to the length of the short period and the denominator of which is the length of a full period.

(3) *Counting convention.* In computing the length of a short period, any reasonable convention may be used. Common conventions are "30 days per month/360 days per year", "actual days per month/actual days per year", and "actual days per month/360 days per year". The examples in the regulations under section 7872 all use the "30 days per month/360 days per year" convention.

(d) *Examples.* This section may be illustrated by the following examples.

Example (1). On February 1, 1986, A makes a $100,000 loan to B for a term of 4 months. The loan in repaid on May 31, 1986. Assume that the applicable Federal rate on February 1, 1986, for a loan of this term is 10 percent, compounded semiannually. Using the exact method, the amount of interest that must be paid on May 31, 1986, if the loan is not to be a below-market loan is $3,3096.16, calculated as follows:

$\$100{,}000 \times [(1 + .10/2^{4/6} - 1] = \$3{,}306.16$

Example (2). Assume the same facts as in Example (1). Using the approximate method, a sufficient amount of interest is stated on the loan if $3,333.33 of interest is payable on May 31, 1986, calculated as follows:

$\$100{,}000 \times [(.10/2) \times (4/6)] = \$3{,}333.33$

§1.7872-13 Computation of foregone interest.

(a) *Demand loans outstanding for an entire calendar year*—(1) *In general.* In the case of a below-market demand loan of a fixed principal amount that remains outstanding for an entire calen-

dar year, the amount of foregone interest (as referred to in §1.7872-6(c)) shall be the excess of—

(i) The result produced when the "blended annual rate" is multiplied by the principal amount of the loan, over

(ii) The sum of all amounts payable as interest on the loan properly allocable to the calendar year (including all amounts of original issue discount allocated to that year under section 1272).

The "blended annual rate" will be published annually by the Commissioner and is determined generally by blending the applicable Federal rates for demand loans outstanding for the entire year.

(2) *Example.* Paragraph (a)(1) may be illustrated by the following example.

Example. On January 1, 1985, A makes a $100,000 demand loan to B with stated interest equal to 9 percent. Interst is payable semiannually on June 30, and December 31. The loan remains outstanding for the entire year. On both June 30, and December 31, 1985, D makes a $4,500 payment of interest to A. Assume that the blended annual rate for 1985 is 10.45 percent. The amount of foregone interest is $1,450, computed as follows:

$10,450 = $100,00 × 10.45 percent
$1,450 = $10,450 − $9,000

(b) *Demand loans outstanding for less than an entire calendar year—(1) In general.* In the case of any below-market demand loan outstanding for less than the calendar year, the amount of foregone interest shall be the excess of—

(i) 'The amount of interest ("I") which would have been payable on the loan for the year if interest accured on the loan at the applicable Federal rate and were payable on the date specified in section 7872(a)(2) and §1.7872-6(b), over

(ii) The sum of all amounts payable as interest on the loan properly allocable to the calendar year (including all amounts of original issue discount allocated to that year under secion 1272).

In general, "I" is determined by assuming daily compounding of interest. However, individual taxpayers who are parties to below-market loans in the aggregate of $250,000 or less may choose (see, §1.7872-11(g)) to compute and report foregone interest under the approximate method set forth in paragraph (b)(2) of this section. If the taxpayer chooses the approximate method but fails to properly compute the amount of foregone interest under that method, the correct amount of foregone interest will be recomputed under the approximate method.

(2) *Approximate method.* Under the approximate method, "I" is calculated as follows:

(i) *Loan outstanding during one semiannual period only.* If a loan is outstanding only during one semiannual period of a calendar year, to determine "I", multiply the principal amount of the loan by one-half the applicable Federal rate based on semiannual compounding in effect for that loan, then multiply the result by a fraction representing the portion of the semiannual period during which the loan was outstanding.

(ii) *Example.* Paragraph (b)(2)(i) of this section may be illustrated by the following example.

Example. A $200,000 interest-free demand loan is outstanding on January 1, 1986, and is repaid on March 31, 1986. Assume that the applicable Federal rate (based on semiannual compounding) for demand loans made in January 1986, is 10 percent. The amount of interest that would have been payable on the loan for the year if the loan provided for interest at the applicable Federal rate determined under the approximate method is $5,000, computed as follows:

$5,000 = $200,000 × (.10/2) × (3/6)

Because no interest is payable on the loan, this amount is also the amount of foregone interest.

(iii) *Loans outstanding during both semiannual periods.* If a loan is outstanding for at least part of each semiannual period (but less than the full calendar year), then, under the approximate method, "I" must be calculated in two steps. First, calculate an amount of interest for the first semiannual period by treating the loan as if it were repaid on June 30, using the approach described in paragraph (b)(3)(i) of this section. Second, add this amount of interest to the principal of the loan, and then calculate an amount of interest for the second semiannual period as if the loan of this higher amount were made on July 1, again using the approach described in paragraph (b)(3)(i) of this section. The sum of these two interest amounts is the value for "I" calculated under the approximate method.

(3) *Examples.* Paragraph (b)(2) of this section may be illustrated by the following examples.

Example (1). On March 1, 1986, A makes a $100,000 interest-free demand loan to B. The loan remains outstanding on December 31, 1986. Assume that the applicable Federal rate for a demand loan made in March 1986, based on semiannual compounding, for the first semiannual period in 1986 is 9.89 percent and that the applicable Federal rate, based on semiannual compounding, for a demand loan outstanding in July 1986 is 10.50 percent. The amount of foregone interest under the exact method is $8,691.76, calculated as follows:

$$\$100{,}000 \times [(1 + .0989/2)^{4/6}(1 + .1050/2) - 1] = \$8{,}691.76$$

Example (2). (i) Assume the same facts as in Example (1). The amount of foregone interest under the approximate method is $8,719.92, calculated as follows:

(ii) For the short period March 1 to June 30, 1986, the amount of foregone interest is $3,296.67, calculated as follows:

$3,296.67 = $100,000 × (.0989/2) × (4/6)

(iii) For the second semiannual period in 1986, the amount of foregone interest is computed by first adding the interest for the first semiannual period ($3,296.67) to the original principal amount to obtain a new principal amount of $103,296.67. Foregone interest for the second semiannual period is then $5,423.08, computed as follows:

$5,423.08 = $103,296.67 × (.1050/2)

(iv) Using the approximate method, the amount of foregone interest for 1986 is $8,719.75 ($3,296.67 + $5,423.08).

(c) *Demand loans with fluctuating loan balances.* If a demand loan does not have a constant outstanding principal amount during a period, the amount of foregone interest shall be computed according to the principles set forth in paragraph (b) of this section, with each increase in the outstanding loan balance being treated as a new loan and each decrease being treated as first a repayment of accrued but unpaid interest (if any), and then a repayment of principal.

(d) *Examples.* This provisions of paragraph (c) of this section may be illustrated by the following examples.

Example (1). (i) On October 1, 1984, C makes a $50,000 interest-free demand loan to D. On October 1, 1985, C makes an additional interest-free demand loan of $25,000 to D. Assume that section 7872 applies to both loans, that the blended annual rate for 1985 is 10.45 percent, and that the applicable Federal rate based on semiannual compounding for demand loans made in October 1985, is 10.50 percent. The amount of foregone interest for 1985 is calculated as follows:

(ii) $50,000 is outstanding for the entire year. The foregone interest on this amount is ($5,000 × .1045) = $5,225.00

(iii) $25,000 is outstanding for the last three months of 1985. Under the exact method, the amount of foregone interest on this portion of the loan is $647.86, computed as follows:

$25,000 × [(1 + .1050/2)^{3/6} − 1] = $647.86

Under the approximate method, the amount of foregone interest is $656.25, computed as follows:

$25,000 × (.1050/2) × (3/6) = $656.25

(iv) The total amount of foregone interest is $5,872.86 ($5,225.00 + $647.86) under the exact method, and $5,881.25 ($5,225.00 + $656.25) under the approximate method.

Example (2). (i) On September 1, 1985, E makes a $100,000 interest-free demand loan to F. The loan agreement requires F to repay $10,000 of the principal amount of the loan at the end of each month that the loan is outstanding. Assume that section 7872 applies to the loan and that the applicable Federal rate based on semiannual compounding for demand loans made in September 1985, is 10.50 percent. The amount of foregone interest for 1985 is calculated as follows:

(ii) $70,000 is outstanding for four months. Under the exact method, the amount of foregone interest on this portion of the loan is $2,429.05, computed as follows:

$70,000 × [(1 + .1050/2)^{4/6} − 1] = $2,429.05

Under the approximate method, the amount of foregone interest on this portion of the loan is $2,450.00, computed as follows:

$70,000 × (.1050/2) × (4/6) = $2,450.00

(iii) $10,000 is outstanding for 3 months. Under the exact method, the amount of foregone interest on this portion of the loan is $259.14, computed as follows:

$10,000 × [(1 + .1050/2)^{3/6} − 1] = $259.14

Under the approximate method, the amount of foregone interest on this portion of the loan is $262.50, computed as follows:

$10,000 × (.1050/2) × (3/6) = $262.50.

(iv) An additional $10,000 is outstanding 2 months. Under the exact method, the amount of foregone interest on this portion of the loan is $172.02, computed as follows:

$10,000 × [(1 + .1050/2)^{2/6} − 1] = $17.02

Under the approximate method, the amount of foregone interest on this portion of the loan is $175.00, computed as follows:

$10,000 × (.1050/2) × (2/6) = $175.00

(v) A final $10,000 is outstanding for 1 month. Under the exact method, the amount of foregone interest on this portion of the loan is $85.65, computed as follows:

$10,000 × [(1 + .1050/2)^{1/6} − 1] = $85.65

Under the approximate method, the amount of foregone interest on this portion of the loan is $87.50, computed as follows:

$10,000 × (.1050/2) × (1/6) = $87.50

(vi) The total amount of foregone interest is $2,945.86 under the exact method, and $2,975.00 under the approximate method.

(e) *Gift term loans and certain loans conditioned on future services*—(1) *In general.* In the case of any gift term loan or any term loan that is treated as a demand loan as provided in §1.7872-10(a)(5), the amount of foregone interest for income tax purposes shall be computed as if the loan were a demand loan, except that:

(i) In applying paragraph (a)(1)(i), use the applicable Federal rate based on annual compounding in effect on the day the loan is made instead of the blended annual rate, and

(ii) In applying paragraph (b), use the applicable Federal rate based on semiannual compounding in effect on the day the loan is made instead of the applicable Federal rate for demand loans in effect during the period for which foregone interest is being computed.

(2) *Example.* The provisions of this paragraph (e) may be illustrated by the following examples:

Example (1). On January 1, 1986, parent P makes a $200,000 gift term loan to child C. The loan agreement provides that the term of the loan is four years and that 5 percent simple interest is payable annually. Both P and C are calendar year taxpayers, and both are still living on December 31, 1986. Assume that the Federal mid-term rate based on annual compounding in effect on January 1, 1986, is 11.83 percent. The loan is a below-market loan. The amount of foregone interest for each year is $13,660.00, computed as follows:

($200,000) × .1183 = $23,660.00
$23,660.00 − $10,000.00 = $13,660.00

For gift tax purposes, an imputed gift is treated as made on January 1, 1986, and is equal to the excess of the amount loaned ($200,000) over the present value of all payments due under the loan, discounted at 11.83 percent compounded annually ($153,360.82), or $41,639.82. For rules for determining the computation of present value, see §1.7872-14.

Example (2). Assume the same facts as in Example (1) except that C repays the loan on September 30, 1987, along with an interest payment of $7,500. For income tax purposes, the imputed payments are treated as transferred on December 31, 1986 and September 30, 1987. The amount of the imputed payments for 1986 are the same as in Example (1). For 1987, under the exact method the amount of foregone interest is $9,994.73, computed as follows:

$17,494.73 = $200,000 × [(1 + .1183)^{9/12} − 1]
$17,494.73 − $7,500 = $9,994.73

For gift tax purposes, the imputed gift is treated as made January 1, 1986, and is the same as in Example (1).

(f) *Allocation of stated interest.* If interest that is payable on a demand loan is properly allocable to a period which includes more than one calendar year, the amount of interest to be allocated to each calendar year is determined by using any reasonable method of allocation.

(g) *Counting conventions*—(1) *whole periods.* All whole periods, whether expressed annually, semiannually, quarterly, or monthly, shall be treated as having equal length. For example, a leap year shall be treated as having the same number of days as a non-leap year; all months shall be treated as having the same number of days.

(2) *Short periods.* In computing the length of a short period, any reasonable convention may be used. See §1.7872-12(c)(2) for a list of conventions commonly used.

§1.7872-14 Determination of present value.

(a) *In general.* This section provides rules for computing the present value of a payment (as referred to in §1.7872-7(a)(1)) to be made in the future. In general, for purposes of section 7872, the present value of a loan payment to be made in the future is the amount of that payment discounted at the applicable Federal rate from the date in the future that the payment is due to the date on which the computation is made. For this purpose, the computation date is the date the loan first becomes subject to section 7872. To determine the present value of a payment, use the applicable Federal rate in effect on the day the loan is made that reflects the compounding assumption (*i.e.*, annual, semiannual, quarterly, or monthly) that is appropriate for the loan. See §1.7872-3(b).

(b) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). (i) On July 1, 1984, corporation A makes a $200,000 interest-free three-year term loan to shareholder B. The applicable Federal rate is 10-percent, compounded semiannually.

(ii) The present value of this payment is $149,243.08, determined as follows:

$$\$149{,}243.08 = \frac{\$200{,}000}{[1 + (.10/2)]^6}$$

(iii) The excess of the amount loaned over the present value of all payments on the loan ($200,000 − $149,243.08), or $50,756.92, is treated as a distribution of property (characterized according to section 301) paid to B on July 1, 1984. The same amount, $50,756.92, is treated as original issue discount under sections 1272 and 163(e).

Example (2). (i) On July 1, 1984, Employer X makes a $3,000 interest-free three year compensation-related term loan to employee Y. On December 1, 1984, E makes an $9,0

interest-free compensation-related demand loan to W. The demand loan remains outstanding throughout December 1984. The two loans are the only loans outstanding between E and W during 1984, and neither is characterized under section 7872(c)(1)(D) as a tax avoidance loan. The applicable Federal rate for all loans for periods before January 1, 1985, is 10 percent, compounded semiannually.

(ii) For the period beginning on July 1, 1984, and ending on November 30, 1984, the provisions of section 7872 do not apply to the $3,000 loan because of the application of the *de minimis* rules of section 7872(c)(3).

(iii) On December 1, 1984, however, the aggregate amount of loans outstanding between E and W exceeds $10,000. As a result, section 7872 applies to both loans for December 1984. Both the imputed transfer and the imputed interest payment with respect to the $9,000 demand loan are determined under section 7872(a). The amount of the imputed transfer by E to W with respect to the $3,000 term loan is determined under section 7872(b)(1). An amount equal to the amount of the imputed transfer with respect o the $3,000 term loan is treated as original issue discount.

(iv) With respect to the $3,000 term loan, the amount of the imputed transfer is equal to the excess of the amount loaned, over the present value of all payments which are required to be made under the $3,000 two-year term loan agreement, determined as of December 1, 1984 (the day section 7872 first applies to the $3,000 loan). The present value of $3,000 payable on June 30, 1987, determined as of December 1, 1984, is $2,331.54, computed as follows:

$$\$2,331.54 = \frac{\$3,000}{(1 + .10/2)^5 + 1/6}$$

The imputed transfer on the $3,000 loan is $668.46 ($3,000.00 − $2,331.54).

(v) The foregone interest on the $9,000 demand loan is determined as of December 31, 1984, with respect to the one month during 1984 to which section 7872 applies to the loan. The amount of foregone interest for 1984 under the exact method is $73.48, computed as follows:

$$\$73.48 = \$9,000 \times [(1 + .10/2)^{1/6} - 1]$$

Example (3). (i) Assume the same facts as in Example (2) except that the provisions of the $3,000 three-year term loan require W to make annual payments of interest at a 5 percent simple rate and except that E makes W the $9,000 loan on November 27, 1985.

(ii) Under the agreement W pays $150 (5 percent of $3,000) on June 30, 1985, June 30, 1986, and June 30, 1987. Since the first of these payments is payable prior to November 27, 1985, only the second and third $150 payments are taken into account. W is treated as paying $150 on June 30, 1986 and $3,150 ($3,000 principal and $150 interest) on June 30, 1987.

(iii) The present value as of November 27, 1984 of the $150 payable on June 30, 1986, is $128.39, computed as follows:

$$\$128.39 = \frac{\$150,000}{(1 + .10/2)^3 + 34/180}$$

(iv) The present value as of November 27, 1984 of the $3,150 payable on June 30, 1987, is $2,445.47, computed as follows:

$$\$2,445.47 = \frac{\$3,150,000}{(1 + .10/2)^5 + 34/180}$$

The sum of these two present values of $2,573.86 ($128.39 + $2,445.47). Therefore, the amount of the imputed transfer with respect to the $3,000 loan is $426.14 ($3,000.00 − $2,573.86).

(v) The foregone interest on the $9,000 demand loan under the exact method is $83.33 ($9,000 × [(1 + .10/2)$^{34/180}$ − 1]).

GIFT TAX REGULATIONS
26 CFR PART 25

Par. 3. The authority for Part 25 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * §25.2512-4 and 25.7872-1 also issued under 26 U.S.C. 7872.

Par. 4. Section 25.25122-4 is amended by adding a new sentence at the end to read as follows:

§25.2512-4 Valuation of notes.

* * * See §25.7872-1 for special rules in the case of gift loans (within the meaning of §1.7872-4(b)) made after June 6, 1984.

Par. 5. New §25.78722-1 is added in the appropriate place to read as follows:

§25.7872-1 Certain Below-Market Loans.

For purposes of chapter 12 of the Internal Revenue Code, relating to gift tax, if a taxpayer makes a gift loan (within the meaning of §1.7872-4(b)) that is a term loan (within the meaning of §1.7872-10(a)(2)) and that is made after June 6, 1984, the excess of the amount loaned over the present value of all payments which are required to be made under the terms of the loan agreement shall be treated as a gift from the lender to the borrower on the date the loan is made. If a taxpayer makes a gift loan that is a demand loan (within the meaning of §1.7872-10(a)(1)) and that is outstanding during any calendar period after June 6, 1984, and not repaid before September 17, 1984, the amount of foregone interest (within the meaning of section 7872(e)(2)) attributable to that calendar period shall be treated as a gift from the lender to the borrower. The *de minimis* exception described in section 7872(c)(2) applies to the gift tax treatment of a gift loan. In the case of a term gift loan, however, once section 7872 applies to the loan, the *de minimis* exception will not apply to the loan at some later date regardless of whether the aggregate outstanding amount of loans does not continue to exceed the limitation amount. For a detailed analysis of section 7872, see the income tax regulations under section 7872, §1.7872-1 through §1.7872-14.

ESTATE TAX REGULATIONS
26 CFR Part 20

Par. 6. The authority for Part 20 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * §20.2031-4 and 20.7872-1 also issued under 26 U.S.C. 7872.

Par. 7. Section 20.2031-4 is amended by adding a new sentence at the end to read as follows:

§20.2031-4 Valuation of notes.

* * * See §20.7872-1 for special rules in the case of gift loans (within the meaning of §1.7872-4(b)) made after June 6, 1984.

Par. 8. New §20.7872-1 is added in the appropriate place to read as follows:

§20.7872-1 Certain below-market loans.

For purposes of chapter 11 of the Internal Revenue Code, relating to estate tax, a gift term loan (within the meaning of §1.7872-4(b)) that is made after June 6, 1984, shall be valued at the lesser of:

(a) the unpaid stated principal, plus accrued interest; or

(b) the sum of the present value of all payments due under the note (including accrual interest), using the applicable Federal rate for loans of a term equal to the remaining term of the loan in effect at the date of death.

No discount is allowed based on evidence that the loan is uncollectible unless the facts concerning collectibility of the loan have changed significantly since the time the loan was made. This section applies with respect to any term loan made with donative intent after June 6, 1984, regardless of the interest rate under the loan agreement, and regardless of whether that interest rate exceeds the applicable Federal rate in effect on the day on which the loan was made.

FOUNDATION AND SIMILAR EXCISE TAXES
26 CFR Part 53

Par. 9. The Authority for Part 53 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * §53.4941(d)-2 also issued under 26 U.S.C. 7872.

Par. 10. Section 53.4941(d)-2 is amended by revising paragraph (c)(2) to read as follows:

§53.4941(d)-2 Specific acts of self-dealing.

* * * * *

(c) *Loans.* * * *

(2) *Loans without interest.* Subparagraph (1) of this paragraph shall not apply to the lending of money or other extension of credit by a disqualified person to a private foundation if the loan or other extension of credit is without interest (determined without regard to foregone interest described in section 7872) or other charge.

OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT
(26 CFR Part 602)

Par. 11. The authority for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 12. §602.601 is amended by adding in the appropriate locations, "§1.78722-11 . . . 1545- ."

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on August 15, 1985, 12:11 p.m., and published in the issue of the Federal Register for August 20, 1985, 50 F.R. 33553)

Notice of Proposed Rulemaking Returns Relating to Mortgage Interest Received in a Trade or Business From Individuals

LR-214-84

SUMMARY: * * *[T]he Internal Revenue Service is issuing temporary regulations relating to the requirement of reporting mortgage interest received in a trade or business from individuals. The text of those temporary regulations also serves as the comment document for this proposed rulemaking.

DATES: Written comments and requests for a public hearing must be delivered by October 21, 1985. The regulations are proposed to be effective for mortgage interest received after December 31, 1984.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-214-84), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Annette J. Guarisco of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, (202) 566-3238 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

The temporary regulations * * * on page 311, this Bulletin] amend Parts 1 and 602 of Title 26 of the Code of Federal Regulations. The temporary regulations are designated by a "T" following their section citation. The final regulations, which this document proposes to base on those temporary regulations, would amend Parts 1 and 602 of Title 26 of the Code of Federal Regulations.

The regulations provide guidance concerning information returns relating to mortgage interest received in a trade or business from individuals as required by section 6050H of the Internal Revenue Code of 1954. Section 6050H was added to the Code by section 145 of the Tax Reform Act of 1984 (Pub. L. 98-369, 98 Stat. 685) [1984-3 C.B. (Vol. 1), 1, 192]. The regulations are to be issued under the authority contained in sections 6050H and 7805 of the Internal Revenue Code of 1954 (98 Stat. 685, 26 U.S.C. 6050H; 68A Stat. 917, 26 U.S.C. 7805). For the text of the temporary regulations, see FR Doc. [T.D. 8047] * * * [on page 311, this Bulletin]. The preamble to the temporary regulations provides a discussion of the rules.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required.

Although this document is a notice of proposed rulemaking that solicits public comments, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, a regulatory flexibility analysis is not required under the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

The collection of information requirements contained in these regulations have been submitted to the Office of Management and Budget (OMB) in accordance with the requirement of the Paperwork Reduction Act of 1980. Comments on those requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on those requirements to OMB also send copies to the Service.

DRAFTING INFORMATION

The principal author of these regulations is Annette J. Guarisco of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

ROSCOE L. EGGER, JR.,

Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on August 16, 1985, 8:45 a.m., and published in the issue of the Federal Register for August 20, 1985, 50 F.R. 33551)

Notice of Proposed Rulemaking Taxation of Fringe Benefits

LR-216-84

SUMMARY: * * * [T]he Internal Revenue Service is issuing temporary income tax regulations under sections 61 and 132. The temporary regulations under section 61 provide rules for valuation of the commuting use of employer-provided vehicles. The temporary regulations under section 132 provide rules relating to working condition fringe exclusions. The text of the temporary regulations serves as the comment document for the notice of proposed rulemaking contained in this document.

DATES: Proposed effective date: The regulations are generally proposed to be effective as of January 1, 1985.

Dates for comments and request for a public hearing: Written comments and requests for a public hearing must be delivered or mailed by January 5, 1986.

ADDRESS: Send comments and requests for a public hearing to Commissioner of Internal Revenue, 1111 Constitution Ave., N.W., Washington, D.C. 20224 Attention: CC:LR:T (LR-216-84).

FOR FURTHER INFORMATION CONTACT: Annette J. Guarisco of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, (202) 566-3918 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

The temporary regulations * * * [on page 93, this Bulletin] amend Part 1 of Title 26 of the Code of Federal Regulations. The temporary regulations are designated by a "T" following their section citation. The final regulations, which this document proposes to base on those temporary regulations, would amend Part 1 of Title 26 of the Code of Federal Regulations.

Section 61 was amended and section 132 was added to the Internal Revenue Code of 1954 ("Code") by section 531 of the Tax Reform Act of 1984 (Pub. Law 98-369, 98 Stat. 877) [1984-3 C.B. (Vol. 1) 1, 385]. Section 274(d) of the Code was amended by section 179 of the Tax Reform Act of 1984 (99 Stat. 494) [1984-3 C.B. (Vol. 1) 1, 221] and section 1(a) of the Repeal of Contemporaneous Recordkeeping Requirements (Pub. Law 99-44, 99 Stat. 77) [page 350, this Bulletin]. Because of the relationship between sections 274(d) and 132 of the Code, the temporary regulations under section 132 are amended.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before these proposed amendments are adopted, consideration will be given to any written comments that are submitted (preferably eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying.

A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

The collection of information requirements contained in the temporary regulations have been submitted to the Office of Management and Budget (OMB) for review under the Paperwork Reduction Act of 1980. Comments on those requirements should be sent to the Office of Information and Regulatory Affairs, Attention: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on the requirements to OMB also send copies of those comments to the Service.

EXECUTIVE ORDER 12291 AND REGULATORY FLEXIBILITY ACT

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required.

Although this document is a notice of proposed rulemaking which solicits public comments, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

DRAFTING INFORMATION

The principal author of this document is Annette J. Guarisco of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 1, 1985, and published in the issue of the Federal Register for November 6, 1985, 50 F.R. 46087)

Notice of Proposed Rulemaking Residential Rental Property

LR-269-84

SUMMARY: This document provides proposed regulations that relate to the tax exempt status of industrial development bonds. Changes to the applicable tax law were made by the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. These regulations affect all purchases, beneficiaries, and governmental issuers of tax exempt industrial development bonds.

DATES: Written comments and requests for a public hearing must be delivered or mailed by January 6, 1986. Generally, the provisions permitting a residential rental project to be part of a mixed-use project are proposed to be effective for obligations issued after April 30, 1968. However, the provisions relating to the definition of low or moderate income are proposed to be effective for obligations issued after December 31, 1985.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-269-84), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Mitchell H. Rapaport of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3740).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 103(b) of the Internal Revenue Code of 1954. The proposed amendments reflect changes to section 103(b)(4) made by sections 614 and 628(e) of the Tax Reform Act of 1984 (Pub. L. 98-369; 98 Stat. 914, 932) [1984-3 C.B. (Vol. 1) 1, 422, 439]. The proposed amendments would also clarify the regulations under section 103(b)(12)(C), relating to the definition of individuals of low and moderate income.

EXPLANATION OF PROVISIONS

Section 103(a) provides that gross income does not include interest on the obligations of a State or political subdivision thereof. Section 103(b)(1) provides that any industrial development bond shall be treated as an obligation not described in section 103(a).

Section 103(b)(4)(A) and §1.103-8(b)(1) provide that section 103(b)(1) shall not apply to an obligation issued as part of an issue substantially all of the proceeds of which are to be used to provide a residential rental project as defined in §1.103-8(b)(4) in which 20 percent or more of the units provided with the proceeds of the issue are to be occupied by individuals or families of low or moderate income.

The notice of proposed rulemaking would amend §1.103-8(b)(4) to provide that a residential rental project will not fail to qualify as such merely because part of the building or structure in which such property is located is used for purposes other than similarly constructed rental units, *e.g.*, commercial office space, owner-occupied residences. Thus for example, a building the first floor of which is used for commercial purposes and the balance of which consists of rental units may qualify as a residential rental project.

In the case of such a mixed-use project, for purposes of determining whether substantially all of the proceeds are to be used to provide a residential rental project only the proceeds to be used to provide rental units that, in the aggregate, meet the low or moderate income occupancy requirement and other portions of the project allocable to such units are treated as providing a residential rental project. For this purpose, the cost of property benefitting, directly or indirectly, both the rental units qualifying for financing and the nonqualifying property must be properly allocated between the units and the nonqualifying property, with only the portion allocable to the units being treated as a cost of providing a residential rental project. In general, the proposed regulations provide that this allocation will be considered proper if made based on the ratio of the amount of floor space in the project to be used for nonqualifying property to the total floor space in the project. However, in those situations in which the use of this allocation method would not reasonably reflect the benefits to be received, directly or indirectly, from such property by the rental units and the nonqualifying property, the allocation may not be made under this method. In such circumstances the allocation may be made under any reasonable method. Comments are specifically requested concerning any other allocation methods that may be appropriate for this purpose.

Section 103(b)(4)(A) and §1.103-8(b) provide that an obligation will be treated as being described in section 103(a) if substantially all of the proceeds of the issue of which such obligation is a part are to be used to provide a project for residential rental property in which at least 20 percent of the units (15 percent in targeted areas) are to be occupied by individuals or families of low or moderate income. Section 1.103-8(b)(8)(v) defines low or moderate income as 80 percent of the median gross income for the area. The proposed regulations would amend the definition of low or moderate income to make clear that median gross income for an area is to be determined with adjustments for family size.

The proposed regulations would amend §1.103-8(b)(3), relating to the transitional rules provided in the Mortgage Subsidy Bond Tax Act of 1980 [Pub. L. 96-499, 1980-2 C.B. 509, 512], to reflect the amendments made to those rules by the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1], which terminated most of those transitional rules for obligations issued after December 31, 1984.

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis therefore is not required.

REGULATORY FLEXIBILITY ANALYSIS

Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

DRAFTING INFORMATION

The principal author of these proposed regulations is Mitchell H. Rapaport of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before the adoption of these proposed regulations, consideration will be given to any written comments that are

submitted (preferably eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

* * * * *

Proposed amendments to the regulations

The proposed amendments to 26 CFR Part 1 as follows:

Paragraph 1. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805. * * *

Par. 2. Section 1.103-8 is amended by revising paragraph (b)(1), (b)(3) and paragraph (b)(4)(i) and (ii), by adding a new paragraph (b)(4)(v), by revising paragraph (b)(5), paragraph (b)(7)(ii), and paragraph (b)(8)(v), by revising *example (3)* of paragraph (b)(9), and by adding new *Example (12)* and *Example (13)* to follow *Example (11)* of paragraph (b)(9). These revised and added provisions read as follows:

§1.103-8 Interest on bonds to finance certain exempt facilities.

* * * * *

(b) *Residential rental property*—(1) *General rule for obligations issued after April 24, 1979.* Section 103(b)(1) shall not apply to any obligation which is issued after April 24, 1979, and is part of an issue substantially all of the proceeds of which are to be used to provide a residential rental project in which 20 percent or more of the units in the project that are to be provided with the proceeds of the issue (other than those units to be provided with an insubstantial amount of the proceeds of the issue as permitted under paragraph (a)(3) of this section) are to be occupied by individuals or families of low or moderate income (as defined in paragraph (b)(8)(v) of this section). See paragraph (b)(4)(v) with respect to mixed-use projects. In the case of a targeted area project, the minimum percentage is 15 percent. See generally §1.103-7 for rules relating to refunding issues.

* * * * *

(3) *Transitional rule.* For purposes of this section, obligations issued after April 24, 1979, may be treated as issued before April 25, 1979, if the transitional requirements of section 1104 of the Mortgage Subsidy Bond Tax Act of 1980 (94 Stat. 2670) [Pub. L. 96-499, 1980-2 C.B. 509, 512, 517], as amended by section 614 of the Tax Reform Act of 1984 (98 Stat. 914) [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1, 422], are satisfied.

(4) *Residential rental project*—(i) *In general.* A residential rental project is a building or structure, together with any facilities functionally related and subordinate thereto, containing one or more similarly constructed units that—

(a) Are not used on a transient basis, and

(b) Satisfy the requirements of paragraph (b)(5)(i) of this section and are available to members of the general public in accordance with the requirements of paragraph (a)(2) of this section.

Although a residential rental project may include other property, such as commercial office space, special rules apply to such mixed-use projects (see paragraph (b)(4)(v)). Hotels, motels, dormitories, fraternity and sorority houses, rooming houses, hospitals, nursing homes, sanitariums, and rest homes are not residential rental projects (but, with respect to obligations issued prior to January 1, 1986, only if such facilities are for use on a transient basis). In addition, trailer parks and courts for use on a transient basis are not residential rental projects.

(ii) *Multiple buildings and partial use of buildings. (a)* Proximate buildings or structures that have similarly constructed units are treated as part of the same project if they are owned for Federal tax purposes by the same person and they are financed pursuant to a common plan.

(b) Buildings or structures are proximate if they are located on a single tract of land. The term "tract" means any parcel or parcels of land that either are contiguous or are contiguous except for the interposition of a road, street, stream or similar property. Parcels are contiguous if their boundaries meet at one or more points.

(c) Similarly constructed units located in a single building and financed pursuant to a common plan of financing are treated as part of the same project.

(d) A common plan of financing exists if, for example, all such buildings or similarly constructed units are provided by the same issue or several issues subject to a common indenture.

* * * * *

(v) *Mixed-use projects. (a)* For purposes of this paragraph (b), a mixed-use project is a building or structure, together with any facilities functionally related and subordinate thereto, containing—

(1) One or more similarly constructed units rented or available for rental that, in the aggregate, meet the low or moderate income occupancy requirement of paragraph (b)(5)(ii), and

(2) Other property the use of which is unrelated to such units, *e.g.*, commercial office space, owner-occupied residences, and units that, in the aggregate, do not meet the low or moderate income occupancy requirement of paragraph (b)(5)(ii) ("nonqualifying property").

(b) For purposes of determining whether, in the case of a mixed-use project, substantially all of the proceeds of the issue are to be used to provide a residential rental project, only the proceeds to be used to provide the units described in paragraph (b)(4)(v)*(a)(1)* and the other portions of the project allocable to such units are treated as being used to provide a residential rental project. Other portions of the project allocable to such units include—

(1) The allocable portion of property benefitting both such units and the nonqualifying property (*e.g.*, common elements), and

(2) All property benefitting only such units (*e.g.*, recreational facilities used only by occupants of the units described in paragraph (b)(4)(v)*(a)(1)*).

(c) In determining whether, in the case of a mixed-use project, substantially all of the proceeds of an issue are to be used to provide a residential rental project, the cost of property that will benefit, directly or indirectly, both the units described in paragraph (b)(4)(v)*(a)(1)* and the nonqualifying

property must be allocated between such units and the nonqualifying property. For example, in the case of a mixed-use project part of which is to be used for commercial purposes, the cost of the building's foundation must be allocated between the commercial portion of the building and the units described in paragraph (b)(4)(v)*(a)(1)*. The allocation of the cost of such common elements may be made according to any reasonable method that properly reflects the proportionate benefit to be derived, directly or indirectly, by the units described in paragraph (b)(4)(v)*(a)(1)* and the nonqualifying property. Allocating the cost of such common elements based on the ratio of the total floor space in the building or structure that is to be used for nonqualifying property to all other floor space in the building or structure is, generally, a reasonable method; however, in the case of any common elements with respect to which an allocation according to this method does not reasonably reflect the relative benefits to be derived, directly or indirectly, by the units described in paragraph (b)(4)(v)*(a)(1)* and the nonqualifying property, the allocation may not be made according to this method. For example, this method would not be a reasonable method for making the allocation in the case of a residential rental project one-half of the floor space of which is used for shopping space where three-fourths of the parking lot for the building will be used to serve the shopping space and the balance of the parking lot will be used to serve tenants of the units described in paragraph (b)(4)(v)*(a)(1)*; the cost of constructing the parking lot must be allocated based on the proportion of the parking lot to be used, directly or indirectly, by the tenants of the units described in paragraph (b)(4)(v)*(a)(1)* and by the owners and tenants of the nonqualifying portion of the project.

(5) *Requirements must be continuously satisfied*—(i) *Rental requirement.* Once available for occupancy, each unit (as defined in paragraph (b)(8)(i) of this section) in a residential rental project that was provided with the proceeds of an issue described in section 103(b0(4)(A) (other than those units provided with an insubstantial amount of the proceeds of the issue as permitted under paragraph (a)(3) of this section) must be rented or available for rental on a continuous basis for the longer of—

(a) the remaining term of the obligation, or

(b) the qualified project period (as defined in paragraph (b)(7) of this section).

(ii) *Low or moderate income occupancy requirement.* Individuals or families of low or moderate income must occupy that percentage of completed units in the project that were provided with the proceeds of an issue described in section 103(b)(4)(A) (other than those units provided with an insubstantial amount of the proceeds of the issue as permitted under paragraph (a)(3) of this section) applicable to the project under paragraph (b)(1) of this section continuously during the qualified project period. For this purpose, a unit occupied by an individual or family who at the commencement of the occupancy is of low or moderate income is treated as occupied by an individual or family of low or moderate income even though the individual or family ceases to be of low or moderate income during the period of their occupancy. Moreover, such unit is treated as occupied by an individual or family of low or moderate income until reoccupied, other than for a temporary period not in excess of 31 days, at which time a redetermination of whether the unit is occupied by an individual or family of low or moderate income shall be made.

* * * * *

(7) *Qualified project period.* * * *

(ii) For obligations issued after September 3, 1982, a period beginning on the later of the first day on which at least 10 percent of the units in the project that are provided with the proceeds of the issue are first occupied or the date of issue of an obligation described in section 103(b)(4)(A) and this paragraph and ending on the later of the date—

(a) Which is 10 years after the date on which at least 50 percent of the units in the project that are provided with the proceeds of the issue are first occupied,

(b) Which is a qualified number of days after the date on which any of the units in the project that are provided with the proceeds of the issue are first occupied, or

(c) On which any assistance provided with respect to the project under section 8 of the United States Housing Act of 1937 terminates.

For purposes of this paragraph (b)(7)(ii), the "qualified number of days" means 50 percent of the total number of days comprising the term of the obligation with the longest maturity in the issue used to provide the project. In the case of a refunding of such an issue, the longest maturity is equal to the sum of the period the prior issue was outstanding and the longest term of any refunding obligations.

(8) *Other definitions.* * * *

(v) *Low or moderate income.* Individuals and families of low or moderate income shall be determined in a manner consistent with determinations of lower income families under section 8 of the United States Housing Act of 1937, as amended, except that the percentage of median gross income that qualifies as low or moderate income shall be 80 percent of the median gross income for the area with adjustments for smaller and larger families. Therefore, occupants of a unit are considered individuals or families of low or moderate income only if adjusted income (computed in the manner prescribed in §1.167(k)-3(b)(3)) does not exceed 80 percent of the median gross income for the area with adjustments for smaller and larger families. With respect to obligations issued prior to January 1, 1986, determinations of low or moderate income shall be made in accordance with the requirements of this paragraph (b)(8)(v) except that median gross income for the area need not be adjusted for family size. Notwithstanding the foregoing the occupants of a unit shall not be considered to be of low or moderate income if all the occupants are students (as defined in section 151(e)(4)), no one of whom is entitled to file a joint return under section 6013. The method of determining low or moderate income in effect on the date of issue will be determinative for such issue even if such method is subsequently changed. In the event programs under section 8(f) of the Housing Act of 1937, as amended, are terminated prior to the date of issue the applicable method shall be that in effect immediately prior to the date of such

termination.

(i) *Examples.* * * *

Example (3). The facts are the same as in example (1), except that the proceeds of the obligation are provided to N, a cooperative housing corporation. N uses the proceeds to finance the construction of a portion of a cooperative housing project. The balance of the project is financed with the proceeds of a note that is not described in section 103(a). Shares in the cooperative carrying the rights to occupy the units in the portion of the project financed with the proceeds of the obligation issued by City X will be sold to shareholders who will rent the units to other persons. The balance of the shares in the cooperative, carrying the rights to occupy more than half of the space in the project, will be sold to individuals who will occupy the units themselves. The project is a residential rental project within the meaning of section 103(b)(4)(A) and this paragraph (b).

* * * * *

Example (12). In July 1985, County X issues a $10 million issue of industrial development bonds to be used to finance the construction of a building to be owned by Corporation W. Corporation W will construct a 10 story building. The first 2 floors of the building will be made available for commercial use. The remaining 8 floors will consist of similarly constructed units that will be made available as residences on a rental basis to members of the general public. Corporation W uses substantially all of the proceeds of the issue to finance the 8 floors of the building to be made available as rental units, the portions of the building benefitting, directly or indirectly, only the rental units, and the portions of the building benefitting, directly or indirectly, both the rental units and the commercial space that are properly allocable to the rental units. The remainder of the building is financed other than with the proceeds of an obligation described in section 103(a). Corporation W will make 20 percent of the rental units available to low or moderate income individuals, and all of the other requirements of this section are met. The obligtions are used to provide a residential rental project within the meaning of section 103(b)(4)(A) and this section, and the obligations are described in section 103(a).

Example (13). The facts are the same as in example (12), except that Corporation W uses the proceeds of the issue to finance the entire building including the 2 floors to be available for commercial use. The cost of the 2 floors available for commercial use, including those portions of the building that benefit both the commercial space and the rental units that are properly allocable to the commercial space, is $2 million. Under paragraph (b)(4)(v) of this section, the building is a residential rental project. However, substantially all of the proceeds of the issue are not used to provide a residential rental project since, in making this determination, proceeds used to provide nonqualifying property are treated as not used to provide a residential rental project. Therefore, the obligations are not described in section 103(b)(4)(A) and this paragraph (b).

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 4, 1985, 12:39 p.m., and published in the issue of the Federal Register for November 7, 1985, 50 F.R. 46303)

Notice of Proposed Rulemaking

Limitation of Investment Credit in the Case of Certain Regulated Companies; Synchronization of Interest

LR-227-84

SUMMARY: This document contains proposed regulations relating to the limitation on the investment credit in the case of certain regulated companies. Questions have arisen concerning the permissibility of synchronization of interest under the ratable flow-through method of accounting for the investment credit with respect to public utility property. The proposed regulations would provide guidance on this issue and would affect regulated companies that use the ratable flow-through method of accounting for the investment credit with respect to public utility property.

DATES: Written comments or requests for a public hearing must be delivered or mailed by July 26, 1985. The amendments are proposed to be effective generally with respect to all property to which section 46(f) applies (generally, pubic utility property constructed or acquired by the taxpayer after August 15, 1971). See section 105(d) of the Revenue Act of 1971 (1972-1 C.B. 443).

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-227-84), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Paulette Chernyshev of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3288, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 46(f) of the Internal Revenue Code of 1954, relating to the limitation on the investment credit in the case of certain regulated companies. Section 46(f) was added to the Code by section 105(c) of the Revenue Act of 1971 (Pub. L. No. 92-178; 85 Stat. 503). [1972-1 C.B. 443, 447]. The proposed amendments clarify the manner in which the limitation applies in the case of regulated companies that use the ratable flow-through method of accounting for the investment credit with respect to public utility property.

EXPLANATION OF PROVISIONS

Section 46(f)(2) permits the use of a ratable flow-through method of accounting for the investment credit with respect to public utility property. Under this method of accounting, the taxpayer's cost of service for ratemaking purposes may be reduced by a ratable portion of the investment credit. The credit is disallowed, however, if the cost of service is reduced by more than a ratable portion of the credit or if the base to which the taxpayer's rate of return for ratemaking purposes is applied ("rate base") is reduced by any portion of the credit.

In determining whether a credit has been used to reduce rate base, §1.46-6(b)(3) of the regulations requires reference to "any accounting treatment that affects the permitted return on investment by treating the credit in any way other than as though it were capital supplied by common shareholders to which a 'cost of capital' rate is assigned that is not less than the taxpayer's overall cost of capital rate." This requirement appears only in the definition of rate base and it is unclear whether the credit also must be treated as capital provided by common shareholders in determining cost of service. As a result, the Service has received a number of ruling requests asking whether a portion of the return on the rate base attributable to the credit may be characterized as interest expense and taken into account in computing Federal income tax expense for ratemaking purposes ("interest synchronization").

This issue is addressed indirectly in several cases reviewing rate orders. Although the permissibility of synchronization of interest was an issue in these reviews, the Internal Revenue Service was not a party to the cases and the decisions did not determine the actual tax

liability of the regulated companies. Two courts of appeals determined that interest synchronization does not violate section 46(f)(2) or the existing regulations. *Union Electric v. FERC*, 668 F.2d 389 (8th Cir. 1981); *Nepco Municipal Rate Commission v. FERC*, 668 F.2d 1327 (D.C. Cir. 1981); *Public Service of New Mexico v. FERC*, 653 F.2d 681 (D.C. Cir. 1981). Other courts, however, concluded that synchronization of interest is not permitted under section 46(f)(2) and the existing regulations. See, *Utilities Commission v. Carolina Telephone & Telegraph*, 300 S.E. 2d 395 (1983).

Although synchronization of interest reduces cost of service, the Service has concluded that this reduction is not attributable to the credit. This conclusion is consistent with financial market realities since, in the absence of the credit, the additional capital needed to finance the investment property generally would be obtained from a similar proportion of debt and equity as in the existing capital structure of the utility. Synchronization of interest properly takes account of the additional interest expense that would have been incurred in those circumstances.

Further, the Service believes that synchronization of interest under section 46(f)(2) results in an appropriate accounting for the credit in establishing rates. The basis for this conclusion may be illustrated by a comparison of the rates that would be established without synchronization of interest with the rates that would be established if the credit were unavailable. Under certain factual circumstances (e.g., long-lived assets with respect to which the credit was allowed), the rates that would be established without synchronization of interest may actually exceed in one or more service years the rates that would be established if the credit were unavailable. In contrast, the rates that would be established with synchronization of interest cannot exceed in any year the rates that would be established if the credit were unavailable. Accordingly, the proposed amendments would clarify that interest synchronization is permitted under a ratable flow-through method of accounting.

More generally, the amendments would provide that the extent to which cost of service or rate base is reduced by reason of the credit is determined by reference to the capital that would have been provided by common and preferred shareholders and long-term creditors if the credit were unavailable. Thus, a reduction in Federal income tax expense to reflect the additional interest the taxpayer would pay or accrue if the credit were unavailable is not treated as a reduction in cost of service by reason of the credit for purposes of section 46(f)(2). Similarly, assigning the credit the overall cost of capital rate, determined on the basis of a weighted average, for the capital that would have been provided if the credit were unavailable is not treated as a reduction in rate base by reason of the credit. The proposed regulations provide that the composition of the capital that would have been provided if the credit were unavailable depends on the facts and circumstances, but permit determinations that additional capital would have been provided in the same proportions and at the same rates of return as the capital actually provided by common and preferred shareholders and long-term creditors.

AMENDMENTS NOT COVERED BY THESE PROPOSED REGULATIONS

The proposed amendments do not reflect amendments made to section 46 after the enactment of the Revenue Act of 1971, other than the redesignation of section 46(e) as section 46(f) by the Tax Reduction Act of 1975 [Pub. L. 94-12, 1975-1 C.B. 545]. In addition, the proposed regulations do not reflect the amendment made to section 167(l)(2)(C) by section 209(d)(3) of the Economic Recovery Tax Act of 1981 (Pub. L. 97-34, 95 Stat. 227) [1981-2 C.B. 256, 287]. That amendment has the effect of eliminating the special rule for immediate flow-through under section 46(f)(3) for property placed in service after December 31, 1980.

REGULATORY FLEXIBILITY ACT; EXECUTIVE ORDER 12291

Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6). The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291, and that a regulatory impact analysis therefore is not required.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner of Internal Revenue by any person who has submitted written comments. If a public hearing is held, notice of the time and place will published in the Federal Register.

DRAFTING INFORMATION

The principal author of these proposed regulations is Paulette Chernyshev of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

* * * * *

Proposed Amendments to the Regulations

The proposed amendments to 26 CFR Part 1 are as follows:

INCOME TAX REGULATIONS (26 CFR Part 1)

Paragraph 1. These regulations are issued under the authority contained in 26 U.S.C. 7805 and 26 U.S.C. 46(f)(7). The authority citation for Part 1 is amended by adding at the appropriate place an additional citation of authority, reading as follows:

§1.46-6 also issued under 26 U.S.C. 46(f)(7).

Par. 2. Section 1.46-6 is amended by revising paragraph (b)(2)(i), (3), and (4)(ii) to read as follows:

§1.46-6 Limitation in case of certain regulated companies.

* * * * *

(b) *Definitions.* * * *

(2) *Cost of service.* (i)(A) For purposes of this section, "cost of service" is the amount required by a taxpayer to provide regulated goods or services. Cost of service includes operating expenses (including salaries, cost of materials, etc.) maintenance expenses, depreciation expenses, tax expenses, and interest expenses. For purposes of this section, any effect on a taxpayer's permitted return on investment that results from a reduction in the taxpayer's rate base does not constitute a reduction in cost of service, even though, as a technical ratemaking term, "cost of service" ordinarily includes a permitted return on investment. In addition, taking into account a deduction for the additional interest that the taxpayer would pay or accrue if the credit were unavailable in determining Federal income tax expense ("synchronization of interest") does not constitute a reduction in cost of service for purposes of section 46(f)(2). This adjustment to Federal income tax expense may be taken into account in determining cost of service for the regulated accounting period or periods that include the taxable year to which the adjustment relates or for any subsequent regulated accounting period.

(B) See paragraph (b)(3)(ii)(B) of this section for rules relating to the amount of additional interest that the taxpayer would pay or accrue if the credit were unavailable.

* * * * *

(3) *Rate base.* (i) For purposes of this section, "rate base" is the monetary amount that is multiplied by a rate of return to determine the permitted return on investment.

(ii)(A) In determining whether, or to what extent, a credit has been used to reduce rate base, reference shall be made to any accounting treatment that affects rate base. In addition, in those cases in which the rate of return is based on the taxpayer's cost of capital, reference shall be made to any accounting treatment that reduces the permitted return on investment by treating the credit less favorably than the capital that would have been provided by common and preferred shareholders and long-term creditors if the credit were unavailable. Thus, the credit may not be assigned a "cost of capital" rate that is less than the overall cost of capital rate, determined on the basis of a weighted average, for the capital that would have been provided by such shareholders and creditors if the credit were unavailable.

(B) For purposes of determining the cost of capital rate assigned to the credit and the amount of additional interest that the taxpayer would pay or accrue, the composition of the capital that would have been provided if the credit were unavailable depends on all the relevant facts and circumstances. For this purpose, however, such capital ordinarily may be considered to be provided by common shareholders, preferred shareholders, and long-term creditors in the same proportions and at the same rates of return as the capital actually provided to the taxpayer by such shareholders and creditors.

(iii) Whether, or to what extent, a credit has been used to reduce rate base for any period to which pre-1986 rates apply will be determined under 26 CFR 1.46-6(b)(3) and (4) (revised as of April 1, 1985) if such a determination avoids disallowance of a credit that would be disallowed under paragraph (b)(3)(ii) or (4)(ii) of this section. For this purpose, a period to which pre-1986 rates apply is any period for which the effect of the credit or rate base for ratemaking purposes is established under a determination put into effect before January 1, 1986 (within the meaning of paragraph (f) of this section).

(4) Indirect reductions to cost of service or rate base. * * *

(ii) One type of such indirect reduction is any ratemaking decision in which the credit is treated as operating income (subject to ratemaking regulation) or is treated less favorably than the capital that would have been provided if the credit were unavailable. For example, if the credit is accounted for as nonoperating income on a company's regulated books of account but a ratemaking decision has the effect of treating the credit as operating income in determining rate of return to common shareholders, then cost of service has been indirectly reduced by reason of the credit.

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on June 21, 1985, 9:22 a.m., and published in the issue of the Federal Register for June 26, 1985 50 F.R. 35385)

Notice of Proposed Rulemaking Reduction of Tax Overpayments by Amount of Past-Due Legally Enforceable Debt Owed to Federal Agency

LR-291-84

SUMMARY: * * * [T]he Internal Revenue Service is issuing temporary regulations relating to the reduction of a taxpayer's overpayment of tax by the amount of any past-due legally enforceable debt owned to a federal agency by the taxpayer and referred by the agency to the Internal Revenue Service for offset. The text of the temporary regulations also serves as the comment document for this notice of proposed rulemaking.

DATES: Written comments and requests for a public hearing must be delivered or mailed by November 29, 1985. The regulations are proposed to apply to refunds payable under section 6402 of the Internal Revenue Code of 1954 after December 31, 1985, and before January 1, 1988 and are effective upon publication.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-291-84), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Sharon L. Hall of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T), (202) 566-3288 (not a toll-free call).

SUPPLEMENTARY INFORMATION

BACKGROUND

The temporary regulations (designated by a "T" following the section citation) * * * [on page 333, this Bulletin] amend Part 301 of Title 26 of the Code of Federal Regulations to provide rules relating to section 6402(d) and (e) of

the Internal Revenue Code of 1954, and section 3720A of subchapter II of chapter 37 of title 31, United States Code, as added by section 2653 of the Spending Reduction Act of 1984 (Pub. L. 98-369, 98 Stat. 1153) [1984-3 C.B. (Vol. 1) 1, 661]. This document proposes to adopt those temporary regulations as final regulations; acordingly, the text of the temporary regulations serves as the comment document for this notice of proposed rulemaking. In addition, the preamble to the temporary regulations provides a discussion of the proposed and temporary rules. For the text of the temporary regulations, see FR Doc. 85-23285 (T.D. 8053) published * * * [on page 333, this Bulletin].

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that these proposed rules are not major rules as defined in Executive Order 12291 and, therefore, a regulatory impact analysis is not required. Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before these proposed regulations are adopted, consideration will be given to any written comments that are submitted (preferably eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

DRAFTING INFORMATION

The principal author of these proposed regulations is Sharon L. Hall of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

JAMES I. OWENS,
Acting Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on September 27, 1985, 8:45 a.m., and published in the issue of the Federal Register for September 30, 1985, 50 F.R. 39713)

Notice of Proposed Rulemaking

Tax Return Preparers

LR-3-85

SUMMARY: This document contains a proposed amendment to the Regulations on Procedure and Administration. The amendment relates to disclosure of tax return information by tax return preparers for the purposes of monitoring and auditing return preparation and for the purpose of assisting the tax return preparer or his legal representative in operating the business in the event of incapacity or death of the tax return preparer. This amendment is made in order to provide guidance to tax return preparers with regard to disclosure of tax return information in this context.

EFFECTIVE DATES: This amendment is proposed to be effective [Date which is 30 days after publication of final regulations in this Federal Register]. Written comments and requests for a public hearing must be delivered or mailed by December 19, 1985.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T [LR-3-85], Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Richard Chewning of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (202-566-3289, not a toll free call).

SUPPLEMENTARY INFORMATION:

This document contains a proposed amendment to the Regulations on Procedure and Administration under section 7216(b)(3) (26 CFR Part 301). The proposed amendment adds a new category to the list of permitted disclosures or use of tax return information without the formal consent of the taxpayer. This amendment is to be issued under the authority contained in section 7216(b)(3) (85 Stat. 529, 26 U.S.C. 7216) and 7805 (68A Stat. 917, 26 U.S.C. 7805) of the Internal Revenue Code of 1954.

DISCUSSION

Section 7216(b) provides that the penalty provision of section 7216(a) will not apply to the disclosure or use of information by preparers of returns if the disclosure is made pursuant to provisions of the Code or pursuant to an order of a court. Section 7216(b)(3) gives the Secretary the regulatory authority to prescribe other exceptions to section 7216(a). Those regulatory exceptions are enumerated in §301.7216-2 (relating to permitted disclosure of tax return information without the formal consent of the taxpayer) and §301.7216-3 (relating to permitted disclosure of tax return information with the formal consent of the taxpayer). This amendment to the regulations would add an additional category of permitted disclosures to §301.7216-2. New proposed §301.7216-2(o) would permit disclosure of tax return information by a tax return preparer for the purpose of permitting the auditing and monitoring of the preparation of tax returns by the tax return preparer. This will assist the tax return preparer to provide the quality of service that the taxpayer expects when he or she goes to the tax return preparer.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting as a final regulation this proposed regulation, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written

comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

REGULATORY FLEXIBILITY ACT OF 1980 AND EXECUTIVE ORDER 12291

The Secretary of the Treasury has certified that this proposed amendment to the regulations would not have significant economic impact on a substantial number of small entities. Accordingly, this proposed amendment to the regulations does not constitute a regulation subject to the Regulatory Flexibility Act of 1980 (5 U.S.C. chapter 6) and a Regulatory Flexibility Analysis is not required and has not been prepared. The Commissioner of Internal Revenue has determined that this proposed rule is not a major regulation subject to Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required.

DRAFTING INFORMATION

The principal author of this regulation is Richard Chewning of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing this regulation, both on matters of substance and style.

* * * * *

Proposed amendment of the regulations

Accordingly, the proposed amendment to 26 CFR Part 301 is as follows:

REGULATIONS ON PROCEDURE AND ADMINISTRATION

1. The authority citation for part 301 continues to read as follows:

Authority: 26 U.S.C. 7805; Section 301.7216-2 is also issued under 26 U.S.C. 7216(b)(3)

2. Section 301.7216-2 is amended by adding a new paragraph (o) at the end thereof, as set forth below:

§301.7216-2 Disclosure or use without formal consent of taxpayer.

* * * * *

(o) *Disclosure of tax return information for the monitoring and auditing of tax return preparation.* The provisions of section 7216(a) and §301.7216-1 do not apply to any disclosure of tax return information made by a tax return preparer to any person who is expected to use such information in connection with the monitoring and auditing of the accuracy of tax returns prepared by the tax return preparer that are to be filed or have been filed with the Internal Revenue Service and to which the tax return information pertains.

In addition, disclosure of tax return information may be made by the tax return preparer for the purpose of assisting the tax return preparer or his legal representative in operating the business in the event of incapacity or death of the tax return preparer. Persons receiving tax return information under the provisions of this paragraph (o) are tax return preparers for purposes of this section.

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 18, 1985, 8:45 a.m., and published in the issue of the Federal Register for November 19, 1985, 50 F.R. 47563)

Notice of Proposed Rulemaking Tax-Exempt Entity Leasing

LR-31-85

SUMMARY: This document provides proposed regulations regarding tax-exempt entity leasing. Changes to the applicable tax law were made by the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. * * * [T]he Internal Revenue Service is issuing temporary regulations relating to tax-exempt entity leasing; the text of those temporary regulations also serves as the comment document for this notice of proposed rulemaking.

DATES: Written comments and requests for a public hearing must be delivered or mailed by September 3, 1985. In general, the regulations are proposed to apply to leases involving tax-exempt entities entered into after May 23, 1983, and to property placed in service by the taxpayer after May 23, 1983. The revisions to the safe-harbor lease reporting requirements are proposed to apply to such lease agreements executed after June 30, 1985.

ADDRESS: Please mail or deliver comments to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-31-85), 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Robert Beatson of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3590).

SUPPLEMENTARY INFORMATION: BACKGROUND

The temporary regulations * * * [on page 73, this Bulletin] add new §§1.48-12T, 1.168(f)(8)-1T, and 1.168(j)-1T to Part 1 of Title 26 of the Code of Federal Regulations. When §1.48-12T is promulgated as a final regulation, it would be renumbered as §1.48-12 of Part 1 of Title 26 of the Code of Federal Regulations. When §1.168(f)(8)-1T is promulgated as a final regulation, it would be renumbered as §1.168(f)(8)-1 of Part 1 of Title 26 of the Code of Federal Regulations. When §1.168(j)-1T is promulgated as a final regulation, it would be renumbered as §1.168(j)-1 of Part 1 of Title 26 of the Code of Federal Regulations. For the text of the temporary regulations, see FR Doc. 85-15846 (T.D. 8033) published * * * [on page 73, this Bulletin]. The preamble to the temporary regulations explains these additions to the Income Tax Regulations.

The proposed regulations provide needed guidance regarding the provisions of section 168(j) and 7701(e) which were enacted by section 31 of the Tax Reform Act of 1984.

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis therefore is not required.

REGULATORY FLEXIBILITY ACT

Although this document is a notice

of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

PAPERWORK REDUCTION ACT

The collection of information requirements contained in the temporary regulations have been submitted to the Office of Management and Budget (OMB) for review under Section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on the requirements to OMB also send copies of those comments to the Service.

DRAFTING INFORMATION

The principal author of these proposed regulations is Robert Beatson of the Legislation and Regulations Division of the Office of the Chief Counsel, Internal Revenue Service. Personnel from other offices of the Internal Revenue Service and the Treasury Department participated, however, in developing the regulations on matters of both substance and style.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adoption of these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. In particular, comments are invited concerning the rules for determining whether partnership allocations are qualified under section 168(j)(9)(B). All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on June 28, 1985, 9:46 a.m., and published in the issue of the Federal Register for July 2, 1985, 50 F.R. 27297)

Notice of Proposed Rulemaking

Information Reporting for Mortgage Credit Certificates

LR-114-85

SUMMARY: This document provides proposed regulations that relate to mortgage credit certificates. Changes to the applicable tax law were made by the Tax Reform Act of 1984 [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1]. These regulations affect all holders and issuers of mortgage credit certificates. In addition, * * *, the Internal Revenue Service is issuing temporary regulations that relate to mortgage credit certificates. The text of those temporary regulations also serves as the comment document for this proposed rulemaking.

DATES: Written comments and requests for a public hearing must be delivered or mailed by November 4, 1985. These regulations are proposed to be effective with respect to mortgage credit certificates issued after September 30, 1985.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-114-85), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Mitchell H. Rapaport of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3740).

SUPPLEMENTARY INFORMATION:

BACKGROUND

The temporary regulations * * * [on page 1, this Bulletin] amend §1.25-4T of Title 26 of the Code of Federal Regulations. The final regulations, which this document proposes to be based on those temporary regulations, would be added to Part 1 of Title 26 of the Code of Federal Regulations. For the text of the Temporary Regulations, see FR Doc. 85-20969 (T.D. 8048) published * * * [on page 1, this Bulletin]. The preamble to the temporary regulations explains the addition to the regulations.

On May 8, 1985, temporary and proposed regulations with respect to mortgage credit certificates were published in the FEDERAL REGISTER (50 FR 19344; 50 FR 19383) [T.D. 8023, 1985-1 C.B. 1; LR-245-84, 1985-1 C.B. 659]. Those regulations reserved §1.25-4T(e), relating to the information reporting requirement, and §1.25-4T(f), relating to the policy statement requirement. The Service received numerous written comments responding to a notice of proposed rulemaking published in the FEDERAL REGISTER on December 12, 1984 (49 FR 48323) [LR-240-84, 1985-1 C.B. 658], with respect to the reporting and policy statement requirements as they apply to qualified mortgage bonds and qualified veterans' mortgage bonds, and a public hearing was held on April 30, 1985. After consideration of all comments regarding those proposed regulations, temporary and proposed regulations relating to the information reporting and policy statement requirements applicable to mortgage credit certificates are being provided.

The regulations interpret the provisions of section 25(g) of the Code, which add certain information reporting requirements to the requirements that mortgage credit cretificate programs must meet.

These regulations are proposed to be issued under the authority of section 25(g) and section 7805 of the Internal Revenue Code (98 Stat. 911, 26 U.S.C. 25(g); 68A Stat. 917, 26 U.S.C. 7805).

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis therefore is not required.

REGULATORY FLEXIBILITY ANALYSIS

Although this document is a notice of proposed rulemaking that solicits

public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of these proposed regulations is Mitchell H. Rapaport of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before the adoption of these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER. The collection of information requirements contained herein have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on the requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests persons submitting comments to OMB also to send copies of the comments to the Service.

JAMES I. OWENS,
Acting Commissioner
of Internal Revenue.

(Filed by the Office of the Federal Register on August 29, 1985, 10:54 a.m., and published in the issue of the Federal Register for September 3, 1985, 50 F.R. 35572)

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Donald Robinson	Anniston, AL	Certified Public Accountant	Indefinite from May 31, 1985
Thomas E. Schneider	Juneau, AK	Enrolled Agent	Indefinite from May 1, 1985
Daniel H. Thomas	Winfield, AL	Certified Public Accountant	Indefinite from May 23, 1985
Jack K. Larabee	Austin, TX	Certified Public Accountant	Indefinite from July 17, 1985
James W. Lewis	Chicago, IL	Enrolled Agent	Indefinite from June 4, 1985
Richard P. O'Connor	Fairfax, VA	Enrolled Agent	Six months from July 1, 1985
Richard D. Stichter	Toledo, OH	Attorney	Indefinite from June 5, 1985
Robert S. Sullivan	Lufkin, TX	Enrolled Agent	Thirty months from June 5, 1985

Name	Address	Designation	Term of Suspension
Russel K. Peavyhouse	Tampa, FL	Attorney	Indefinite from July 1, 1985
Ronald G. Ralston	Dalton, GA	Certified Public Accountant	Indefinite from July 26, 1985
Joseph Basiak	Sun City, AZ	Enrolled Agent	Twelve Months from August 29, 1985
Carl Dubinsky	Woodland Hills, CA	Certified Public Accountant	Indefinite from August 29, 1985
Albert W. Fisher	Albany, NY	Attorney	Indefinite from August 9, 1985
Keith V. Black	Anderson, CA	Enrolled Agent	Eighteen Months from September 10, 1985
Howard C. Flomenhoft	Riverwoods, IL	Attorney	Indefinite from September 11, 1985
John A. Engleson	Pocatello, ID	Certified Public Accountant	Indefinite from September 23, 1985
Floyd H. Pittman	Columbus, GA	Certified Public Accountant	Indefinite from September 23, 1985
Arnold Asman	Great Neck, NY	Certified Public Accountant	Indefinite from October 23, 1985
Thomas P. Cornett	Toledo, OH	Enrolled Agent	Indefinite from December 1, 1985
Horace N. Tremelling	Spring Valley, CA	Enrolled Agent	Indefinite from October 17, 1985

Name	Address	Designation	Term of Suspension
Frank Riggsby, Jr.	Sierra Vista, AZ	Enrolled Agent	Indefinite from October 17, 1985
Edward L. Lambert	Rancho Mirage, CA	Certified Public Accountant	From November 6, 1985 Until January 8, 1990
Benjamin Ostfield	Minneapolis, MN	Attorney and Certified Public Accountant	Indefinite from November 20, 1985
Kenneth D. Short	Ellicott City, MD	Attorney	Indefinite from November 6, 1985

Under Section 330, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any attorney, certified public accountant, enrolled agent, or enrolled actuary who has violated the rules and regulations governing such practice.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will continue to appear in the weekly Bulletin for five successive weeks for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing, the following individuals have been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Gary E. Early	Gonzalez, FL	Certified Public Accountant	June 24, 1984
Allan T. Quello	Wayzata, MN	Attorney	October 12, 1985

Announcement of the Resignation of Enrolled Agents From Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an enrolled agent in order to avoid the institution of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his resignation. The Director of Practice, in his discretion, may accept the offered resignation of an enrolled agent.

To enable the public and other practitioners to identify such resigned enrolled agents, the Director of Practice will announce in the Internal Revenue Bulletin the name and address of each enrolled agent who has resigned and the effective date of resignation. This announcement will appear in the weekly Bulletin at the earliest practicable date after the action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each resigned enrolled agent, and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have entered a consent resignation from enrollment to practice before the Internal Revenue Service:

Name of Enrolled Agent	Address	Effective Date of Resignation
Katheleen McAnnally	Warrior, AL	June 5, 1985
George N. Pelletier	Las Vegas, NV	July 15, 1985
Daniel H. Hess	Ogden, UT	July 24, 1985
David A. Ostrager	Brooklyn, NY	July 23, 1985

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The abbreviation and number in parentheses following the index entry refer to the specific item; numbers following the parentheses refer to the page number on which it appears.

Key to Abbreviations:

RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
SPR	State of Procedural Rules
PTE	Prohibited Transaction Exemption

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